

# **The Concept of Fundamental Breach and Avoidance under CISG**

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**A thesis submitted for the degree of Doctor of Philosophy**

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## **Abstract**

This study explores the concept of fundamental breach and the remedy of avoidance under the CISG. It examines CISG literature and case law in the area of avoidance and identifies several theoretical and practical issues associated with the current understanding of avoidance as a remedy of last resort. Almost every aspect of the CISG is open to interpretation because there is neither a higher court to ensure its uniform application nor official guidance on disputed provisions. This fact is very clear with regard to the remedy of avoidance and the concept of fundamental breach. This study addresses the legal and practical problems associated with this area of research.

This study proposes that the current understanding of the CISG's remedy of avoidance as a remedy of last resort is not truly reconcilable with the legal practices in this area. Courts and arbitral tribunals have occasionally ruled in favour of avoidance without discussing whether there was still a possibility for the aggrieved party to benefit from the defective performance in some other way. This study shows that in cases where the right to avoid the contract arises, whilst the principle of favor contractus should not be neglected, it plays a far less significant role than other CISG general principles such as protecting trust in international trade, the good faith principle, reasonability, the principle of full compensation and the principle that promises must be observed. By employing the fundamental breach that is based on depriving the promisee of his legitimate expectations as seen from the promisor or a reasonable promisor's perspective, the CISG provides judges and arbitrators with ample tools to apply their discretion on a case by case basis in order to judge whether avoidance was rightfully declared. There is no single abstract rule that governs the fundamentality of the breach under the CISG.

## **Declaration**

This thesis has not been accepted in any previous application for a degree. The work on which the thesis is based has been done entirely by the candidate.

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## **Dedication**

For my father, in memoriam

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## Introduction

The worldwide acceptance of the Vienna Convention of 1980<sup>1</sup> has made it a truly uniform law which governs the sale of goods.<sup>2</sup> Before the CISG was created, drafters thought that their efforts would only increase legal certainty and reduce the transaction costs for international buyers and sellers.<sup>3</sup> However, a survey of legal literature on the CISG shows that the Vienna Convention is not the perfect law for international sales. There is confusion, insecurity and ambiguity about most of the issues that cover contract formation and performance. Fundamental breach and avoidance under the CISG is one of the most troublesome areas of the Convention. The aggrieved party may avoid the contract by mere declaration if the other party has fundamentally breached the contract. The CISG provides a definition in Article 25 to distinguish between fundamental and simple breach of contract, suggesting a preference for keeping the contract rather than instigating avoidance. Articles 49(1)(a) and 64(1)(a) of the Convention allow a party to avoid a contract if the other party has committed a fundamental breach within the meaning of Article 25 CISG. Articles 49(1)(b) and 64(1)(b) CISG provide an alternative way to avoid the contract for certain breaches through a procedure called *Nachfrist*. The legal literature is in dispute over the meaning of Article 25 CISG and the conditions of Articles 49 and 64 CISG. The legal consequences of a fundamental breach related to avoidance, such as the amount of damages

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<sup>1</sup> United Nations Convention on Contracts for International Sale of Goods (11 April 1980, entered into force 1 January 1988) 1489 UNTS 3 (CISG/Vienna Convention/The Convention).

<sup>2</sup> As of 26 September 2013, UNCITRAL reports that 80 States have adopted the CISG. For a table of Contracting States see <<http://www.cisg.law.pace.edu/cisg/countries/cntries.html>> accessed 20 September 2015. Commentators have often stated that the CISG is a success. See Stacey A Davis, 'Unifying the Final Frontier: Space Industry Financing Reform' (Winter 2001) 106 Commercial Law Journal 455, 477; Sandeep Gopalan, 'The Creation of International Commercial Law: Sovereignty Felled?' (2004) 5 San Diego International Law Journal 267, 289; Kazuaki Sono, 'The Rise of a National Contract Law in the Age of Globalization' (2001) 75 Tulane Law Review 1185, 1185.

<sup>3</sup> The preamble of the CISG provides that the Convention sets out to 'contribute to the removal of legal barriers in international trade and promote the development of international trade'; Peter Winship, 'Background Of The United Nations Sales Convention, Export-Import Sales Under the 1980 United Nations Sales Convention' (1984-1985) 8 Hastings International & Comparative Law Review 197; Ernst Rabel, 'The Hague Conference on the Unification of Sales Law' (Winter-Spring 1952) 1(1-2) American Journal of Comparative Law 58.

and some aspects of restitution, are also disputed. The CISG has left many aspects of this subject unsettled and this endangers the position of the CISG as a successful platform for future efforts in international law harmonization as well as the uniform application of the CISG.<sup>4</sup> The uncertainty in CISG application may lead to an increase in the cost of international transactions because the parties to an international sale contract will feel the need to opt out of CISG and seek better, more predictable domestic law for their transaction. Certainly, such an option involves the cost of providing international experts and legal advisors. In addition, the option to opt out of CISG would render the efforts in enshrining the Convention meaningless if opting out became very common. These legal flaws hinder the development of international trade and justify the research efforts in this area.

### **Previous work on the subject**

Research on the avoidance of international sales contracts brings us back to the early project of the League of Nations on the uniform law at The Hague 1935 which was based on the efforts of Professor Ernst Rabel and was aimed at harmonizing private commercial law. Rabel carried out a comprehensive study of rights and obligations of buyers and sellers in comparative legal systems. Rabel's study and the Hague 1935 project distinguish between fundamental and ancillary obligations. The aggrieved party is not allowed to avoid the contract unless the violated obligation could be classified as fundamental in a similar approach to that of traditional English common law which distinguishes between warranty and condition.<sup>5</sup> However, this approach does not fulfil the needs of an international sales

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<sup>4</sup> Some scholars have doubted whether the CISG has been beneficial to commercial parties due to the poor quality of harmonization that it has achieved. See Clayton P Gillette and Robert E Scott, 'The Political Economy of International Sales Law' (2005) 25 *International Review of Law and Economics* 446; Paul B Stephan, 'The Futility of Unification and Harmonization in International Commercial Law' (1999) 39 *Virginia Journal of International Law* 743; Gilles Cuniberti, 'Is the CISG Benefiting Anybody?' (2006) 39 *Vanderbilt Journal of Transnational Law* 1511, 1512.

<sup>5</sup> Ernst Rabel, *Das Recht des Warenkaufs. Eine rechtsvergleichende Darstellung* (Walter de Gruyter & Co 1936); Hannes Rösler, 'Siebzig Jahre Recht des Warenkaufs von Ernst Rabel Werk - und Wirkgeschichte'

contract since it allows avoidance of the contract for breach of essential condition even in circumstances where the breach caused relatively little or only negligible damage. Due to this, during the preparatory work for the Uniform Law on the International Sale of Goods (ULIS) in 1951, the Danish representative tried to bestow upon the avoidance remedy a more accurate criterion; he suggested the concept of fundamental breach of any contractual obligation instead of the notion of breach of a fundamental obligation as a prerequisite for the availability of the aggrieved party's right to avoid the contract.<sup>6</sup> This notion was accepted and included in several drafts of the ULIS and its successor: the CISG. However, the definition of fundamental breach is disputed and is not easy to comprehend.

The CISG devoted Article 25 of the Convention to define fundamental breach. Article 25 CISG defines fundamental breach by reference to the result of the breach in foreseeable detriment to the injured party. Two conditions must be satisfied in order to classify a breach as fundamental: detriment and foreseeability. The breach is fundamental when it results in detriment that substantially deprives the other party of what it is entitled to expect under the contract, provided that the party in breach did foresee or a reasonable person of the same kind in the same circumstances could have foreseen such a result. Although such an abstract definition does not offer a precise meaning of the term for the purposes of contract avoidance,<sup>7</sup> the early scholarly writing emphasized the principle of *favor contractus* and provided a strict test to detect the substantial detriment. Commentators have also disputed the meaning of fundamental breach. The interpretation provided is that in cases of alleged fundamental breach, maintaining the contract should be favoured over avoidance due to the

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[Seventy Years of the Sale of Goods by Ernst Rabel - A History of the Book and its Effects] (2006) 70(4) Rabel Journal of Comparative and International Private Law 793.

<sup>6</sup> Darren Peacock, 'Avoidance and the Notion of Fundamental Breach under the CISG: An English Perspective' (2003) 8 International Trade and Business Law Review 95, 99.

<sup>7</sup> The aggrieved party's right to avoid the contract based on fundamental breach is confirmed in Articles 49(1)(a), 51(2), 64(1)(a), 72(1) and 73(1), (2) CISG (n 1). An additional but independent avenue, the Convention (in limited specified cases of non-delivery, non-payment, or failure to take delivery) allows avoidance of the contract after the buyer or the seller has fixed *Nachfrist*, an additional period of time, and the other party has not performed within the period so fixed. See Articles 49(1)(b) and 64(1)(b) CISG (n 1).

nature of international sales and the cost of unwinding the contract. It has been assumed that in an international sales contract the remedy of avoidance should not be granted unless the gravity of the breach is manifestly unacceptable.

The classic legal policies such as sanctity of contracts and the economic burdensome of unwinding the contract have been submitted in support of favouring maintaining the contract against the aggrieved party's right of avoidance because of the breach. The principle of sanctity of contracts requires contracts to be kept. The contractual consensus of the parties is the driving force behind the creation and evolution of transnational commercial law.<sup>8</sup> That is, the right of a party to avoid the contract directly contradicts the principle of the sanctity of contracts even if the performance becomes unfavourable or excessively difficult for one of the parties.<sup>9</sup> The other argument is the economic efficiency based on the cost of unwinding the contract such as those costs associated with the return or storage of goods.<sup>10</sup> Contract avoidance burdens the breaching seller with wasteful reshipment or re-disposition of goods in a foreign country and this involves high risk of damage to, or even loss of, the goods because in a considerable number of countries it is not possible to use or return rejected goods immediately. There is, accordingly, an imminent danger that they will perish.<sup>11</sup> It is also burdensome to a breaching buyer if he has already made investments in expectation of the delivery and now faces damages claims from his sub-buyers because of non-delivery. The

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<sup>8</sup> Bertram Keiler, 'Favor Contractus in the CISG' in Camilla B Andersen and Ulrich G Schroeter (eds), *Sharing International Commercial Law across National Boundaries: Festschrift for Albert H. Kritzer on the Occasion of his Eightieth Birthday* (Simmons & Hill 2008) 250.

<sup>9</sup> Anna Kazimierska, 'The Remedy of Avoidance under the Vienna Convention on the International Sale of Goods' [1999-2000] *Pace Review of the Convention on Contracts for the International Sale of Goods* 79, 81.

<sup>10</sup> Peter Schlechtriem, 'Subsequent Performance and Delivery Deadlines - Avoidance of CISG Sales Contracts Due to Non-conformity of the Goods' (2006) 18(1) *Pace International Law Review* 83, 83ff; Franco Ferrari, 'Fundamental Breach of Contract under the UN Sales Convention: 25 Years of Article 25 CISG' (Spring 2006) 25 *Journal of Law and Commerce* 489, 491; Andrea Björklund, 'Article 25' in Stefan Kröll, Loukas A Mistelis and Maria del Pilar Perales Viscacillas, *The United Nations Convention on Contracts for the International Sale of Goods* (CH Beck-Hart-Nomos 2011) 334, para 1.

<sup>11</sup> Shinichiro Michida, 'Cancellation of Contract' (1979) 27 *American Journal of Comparative Law* 279, 281; Peter Huber and Alastair Mullis, *The CISG: A new textbook for students and practitioners* (Sellier 2007) 184; André Janssen and Sörren Claas Kiene, 'The CISG and Its General Principles' in André Janssen and Sörren Claas Kiene (eds), *CISG Methodology* (Sellier 2009) 274.



avoidance therefore deprives the party in breach of the benefit of the contract, including the lost profit, and renders any prior investments futile.<sup>12</sup> That is to say, the economic loss could provide good reason to protect the contract against avoidance.<sup>13</sup>

CISG jurisprudence includes a number of variations on the meaning of fundamental breach. Ziegel submits that the fundamental breach as defined in Article 25 of the Convention is exactly the same as the English doctrine of breach of fundamental term although the draftsmen of the Convention did not intend to adopt any domestic concept.<sup>14</sup> Huber suggests that both the distinction between conditions and warranties and the doctrine of intermediate terms are based on similar criteria as the fundamental breach concept of the Convention texts.<sup>15</sup> Magnus has approached the fundamentality of the breach from the perspective of damages. He states that the extent of monetary loss suffered as a result of the non-performance in relation to the overall value of the contract can be considered as a directly related factor in determining the fundamental breach.<sup>16</sup>

Schlechtriem suggests that the breach is fundamental if it is frustrating the contract purpose. In order to meet this test, it is necessary for the party, as a consequence of the breach, to have no interest in carrying out the contract.<sup>17</sup> One author understands detriment not as a static

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<sup>12</sup> Ulrich Magnus, 'The Remedy of Avoidance of Contract under CISG; General Remarks and Special Cases' (2005-06) 25 *Journal of Law and Commerce* 423.

<sup>13</sup> Clemens Pauly, 'The Concept Of Fundamental Breach As An International Principle To Create Uniformity Of Commercial Law' (2009) 19 *Journal of Law & Commerce* 221, 225.

<sup>14</sup> Jacob S Ziegel, 'Ch. 9: The Remedial Provisions in the Vienna Sales Convention: Some Common Law Perspectives' in Nina M Galston and Hans Smit (eds), *International Sales: The United Nations Convention on Contracts for the International Sale of Goods* (Matthew Bender 1984) 9.

<sup>15</sup> Peter Huber, 'CISG: The Structure of Remedies' (January 2007) 71 *Rechts Zeitschrift für Ausländisches und Internationales Privatrecht* 13, 25.

<sup>16</sup> Ulrich Magnus, 'UN-Kaufrecht' in Julius von Staudingers, *Kommentar zum Bürgerlichen Gesetzbuch mit Einführungsgesetz und Nebengesetzen* (13th edn, Sellier/de Gruyter 1995) article 7 no 13 cited in Robert Koch, 'The Concept of Fundamental Breach of Contract' (1999) *Review of the Convention on Contracts for the International Sale of Goods (CISG)* 177 at note 114; Andrew Babiak, 'Defining "Fundamental Breach" Under the United Nations Convention on Contracts for the International Sale of Goods' (Spring 1992) 6 *Temple International and Comparative Law Journal* 113, 120; Leonardo Graffi, 'Case Law on the Concept of "Fundamental Breach" in the Vienna Sales Convention' (2003) 3 *International Business Law Journal* 338.

<sup>17</sup> Ziegel (n 14) 9; Koch (n 16) 267; Peter Schlechtriem, *Uniform Sales Law: The UN-Convention on Contracts for the International Sale of Goods* (Manz 1986) 59; Fritz Enderlein and Dietrich Maskow, *International Sales Law* (Oceana 1992) 113.

element but, in many instances, as one that occurs only when the breach of contract continues and cannot be adequately compensated in damages.<sup>18</sup>

Understanding fundamental breach according to the above views does not help to provide a consistent interpretation of the court decisions in the application of fundamental breach in cases with similar circumstances. Some researchers conclude that the courts tend to interpret CISG based on views extracted from their domestic law. Based on this fact, the new CISG doctrine doubts the concept of avoidance as last resort. The recent efforts of scholars are focused on finding a way to breathe new life into the definition of fundamental breach. A recent view is that the arguments of sanctity of contracts and economic efficiency are not very strong and they can also be used to support avoidance of contract. The aggrieved party must be entitled to an extensive right to terminate the contract for reasons of non-compliance with any of its terms. Keeping the contract despite the breach may weaken the binding force of contractual commitments. Requiring the innocent party to fulfil his obligations while the other party is in breach of the contractual terms contradicts the principle of sanctity of contracts as the breaching party is not being bound by the same bond.<sup>19</sup> Therefore, the aggrieved party must be allowed access to a legal expedient that releases him from unproductive contractual commitments. In addition, the cost of unwinding the contract should not be used to hinder the aggrieved party's right to void the contract. The definition of fundamental breach does not distinguish whether the avoidance is costly or not. Ferrari suggests that the concept of fundamental breach should be defined on the basis of the

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<sup>18</sup> *ibid* 113; Ingeborg Schwenzer, 'The Right to Avoid the Contract' (2012) 3 *Annals FLB - Belgrade Law Review* 207, 210.

<sup>19</sup> Michael Bridge, 'Avoidance for Fundamental Breach of Contract under the UN Convention on the International Sale of Goods' (2010) 59 *International and Comparative Law Quarterly* 911, 915.

elements by which it is characterised such as breach of an obligation, detriment, legitimate expectations and foreseeability.<sup>20</sup>

Similarly, Bridge suggests that the fundamentality of the breach depends entirely on the injured party's expectations as actually laid down and circumscribed by the individual terms of the particular contract in question and according to the actual breach that has occurred.<sup>21</sup>

However, the relationship between detriment and foreseeability is not clear and needs to be defined. There has been very little discussion on the second element of fundamental breach: foreseeability. This study attempts to address the gap in this area of the Convention.

### **The scope of the study**

The study explores avoidance under CISG and whether it is necessary to keep avoidance as a remedy of last resort in order to maintain a correct interpretation of CISG general principles or if it is even reconcilable with court practices. The study addresses the concepts of fundamental breach and how the foreseeability of detriment shapes the circumstances under which avoidance can be permitted or forfeited. The study will not deal with other aspects of the CISG unless such aspects have a special relationship with fundamental breach and avoidance. The study, when appropriate, will also compare the parallel solutions to avoidance under other international instruments and domestic laws in order to provide a better understanding of avoidance. The purpose of comparison is neither to seek foreign solutions to transplant into CISG nor to prove one system to be more effective than the other. Comparisons of avoidance between the CISG's remedies and its domestic counterparts can help to translate the Convention's message into an understandable medium. This is because

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<sup>20</sup> Ferrari (n 10) 496ff.

<sup>21</sup> UG Schroeter, 'Article 25' in Ingeborg H Schwenzer (ed), *Schlechtriem and Schwenzer, Commentary on the UN Convention on the International Sale of Goods (CISG)* (3rd edn, Oxford University Press 2010) para 4 and para 21; Björklund (n 10) 337; Joseph Lookofsky, 'The 1980 United Nations Convention on Contracts for the International Sale of Goods' in J Herbots and R Blanpain (eds), *International Encyclopaedia of Laws - Contracts*, Suppl 29 (December 2000) 79.

the CISG's interpretation rules preclude resorting to domestic laws to interpret the Convention. Therefore, the nature of this study would require both commentarial and analytical research to fully answer the research questions. A combination of the Convention's provisions and its documentary history, scholars' commentaries, courts' and arbitral tribunals' decisions from different jurisdictions will be used in an attempt to answer the research questions.

The study is divided into eight chapters in addition to the introduction and conclusion. The first chapter deals with the circumstances under which the innocent party will be entitled to avoid the contract for fundamental breach. It aims to explore the basic principles and relevant provisions that govern the availability of avoidance under the Convention. The availability of avoidance under CISG is compared with other international sale instruments: ULIS, UNIDROIT Principles (PICC) and PECL, in order to broaden the understanding of the issues under discussion. Chapter two deals with the relevant rules of the notice that is used when declaring avoidance to the defaulting party. The notice is a crucial part of the avoidance mechanism under the Convention. A properly issued notice will safeguard a party's ability to seek avoidance while an imperfect notice may render avoidance ineffective. Therefore, it is important to ascertain the validity of the notice to recognize rightful avoidance. Chapter three discusses restricting the innocent party's right to declare avoidance within a reasonable time. It aims to interpret the term reasonable time and explain where the time limitations for avoidance apply under the CISG. Chapter four discusses the theoretical bases of fundamental breach in the light of the underlying policies of the Convention. It analyses the wording and drafting history of Article 25 CISG in order to define fundamental breach concept. Chapter five discusses the importance of parties' intentions in defining the fundamental breach of their contract. It aims to uncover the contractual expectations across different aspects of the contract such as negotiations, any practices which the parties have established between

themselves, usages and any subsequent conduct of the parties. Chapters six and seven research the concept of fundamental breach in practice. Chapter six researches the question where the breach of non-performance and late performance become fundamental. Chapter seven discusses the problematic question of fundamental breach for non-conformity. It aims to address a number of specific questions: What is the relevant time of nonconformity? Should the goods comply with the norms in the seller's country or the buyer's, or some other norms? Can the buyer avoid the contract if the goods are totally unsuitable for the intended purpose for which they were bought? Can the buyer avoid the contract if the goods are not strictly in compliance with the contract specifications? Does the seller have a right to cure his fundamental breach of nonconformity? Chapter eight discusses the consequences of avoidance. Specifically, the following questions will be addressed: Does the avoided contract cease to exist retrospectively or prospectively? To what extent can the contractual terms be valid despite avoidance? Is the innocent party entitled to damages if he opts to avoid the contract? How should these be calculated? How restitution to be performed and what is the subject matter of restitution? The study attempts to answer these questions in the light of policies that lie behind empowering or restricting the innocent party to avoid the contract.

## **Chapter One: Avoidance under the CISG and other international instruments**

Sale of goods contracts in the international trade environment deserve unique legal treatment as they are so different from sales in domestic trade. The use of domestic law is not appropriate for governing international transactions since the parties to international sales contracts come from different corners of the world and from different legal backgrounds. A further argument that is sometimes cited is that the goods sold are transferred across international borders and mostly over long distances, and this risks their damage in transport, creates additional costs of insurance, carriage, and export and import complexities. To some extent, these facts have shaped the principles and concepts that dictate how international sales laws should look in terms of relevant remedies available to the innocent party in case of non-performance by the other; in particular, the remedy of avoidance. The remedy of avoidance is said to be available only in exceptional situations as a last resort. In general, the maintenance of the contract should be favoured over avoidance. This chapter aims to explore the basic principles and relevant provisions that govern avoidance of contract under the Convention. The solution under the CISG is compared with other international sale instruments: ULIS,<sup>1</sup> UNIDROIT Principles (PICC)<sup>2</sup> and PECL,<sup>3</sup> where appropriate, in order to broaden the understanding of the issues under discussion.

### **1.1 The concept of breach**

In the process of creating the CISG, the concept of uniform breach was invented and adopted instead of using already tested mechanisms known under domestic laws. The uniform breach

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<sup>1</sup> Convention Relating to a Uniform Law for the International Sale of Goods (1 July 1964) 834 UNTS 169 (ULIS).

<sup>2</sup> UNIDROIT, *Principles of International Commercial Contracts* (3<sup>rd</sup> edn, 2010) (PICC).

<sup>3</sup> Commission on European Contract Law, *Principles of European Contract Law* (Parts I and II revised 1998, Part III 2002) (PECL).

concept has an impact on the entire system of remedies available for international buyers and sellers under CISG.

### **1.1.1 The concept of uniform breach in CISG**

Unlike ULIS and many domestic codifications that distinguish between various types of violation of contract, the Convention acknowledges a uniform notion of breach.<sup>4</sup> In general, the Convention's substantive provisions implement the concept of uniform failure to perform any obligation of the contract. There is no specific type of breach that would result in the right to avoidance. Any failure could amount to fundamental breach according to its consequences.<sup>5</sup> This merger of remedies based on the uniform breach or non-performance was not employed under ULIS. ULIS joined each obligation with a proper remedy or remedies for its breach. While such fragmentation in ULIS made the merchant immediately aware of the potential legal consequences of the breach, it resulted in too many cross-references and repetitive remedial provisions. This repetitive formulation, not the fragmented system of remedies, was criticized; therefore, the Convention's drafters suggested a simpler system and united all the obligations in one section and all the remedies in another.<sup>6</sup> The uniform concept of breach has also been adopted in the UNIDROIT Principles and the PECL. Both of these instruments define non-performance in a similar way to breach of contract used in the CISG in order to include all forms of defective performance, be it a complete failure to perform or a performance which is defective too early, too late or never.<sup>7</sup>

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<sup>4</sup> Michael Will, 'Article 45' in CM Bianca and MJ Bonell (eds), *Commentary on the International Sales Law* (Giuffrè 1987) 331.

<sup>5</sup> United Nations Convention on Contracts for International Sale of Goods (11 April 1980, entered into force 1 January 1988) 1489 UNTS 3 (CISG/Vienna Convention/The Convention). Article 25 CISG provides a definition for fundamental breach.

<sup>6</sup> Will (n 4) 330.

<sup>7</sup> Article 7.1.1 UNIDROIT Principles (n 2) provides that: 'Non-performance is failure by a party to perform any of its obligations under the contract, including defective performance or late performance'; PECL (n 3) Article 8:101(1) provides that: 'Whenever a party does not perform an obligation under the contract and the non-

The CISG's concept of uniform breach is emphasized in Articles 45 and 61 CISG. These two articles enumerate the remedies available for the injured buyer or the injured seller, respectively, if the party in breach 'fails to perform' any of his obligations under the contract or the Convention.<sup>8</sup> The notion of breach or 'fails to perform' refers to all non-performance of any of the obligations of the party in breach that are stated in the Convention or stipulated expressly or impliedly in the contract, no matter whether these obligations are of major or minor importance.<sup>9</sup> It includes all kinds of non-performance, such as non-delivery, late delivery, non-conformity and defective performance;<sup>10</sup> it also includes both excusable and inexcusable non-performance.<sup>11</sup> Generally, every failure to perform an obligation regardless of the nature of the obligation breached or the way in which it took place entitles the aggrieved party to the enumerated remedies in Articles 45 and 61 CISG.

The consolidation of remedies based on the uniform concept of breach is not without criticism. It does not follow the logical importance of contractual interests in performance for every single obligation. Closer observation reveals that some remedies apply only to particular kinds of breach by the seller,<sup>12</sup> and further remedies expressed in Articles 73 CISG

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performance is not excused under Article 8:108, the aggrieved party may resort to any of the remedies set out in Chapter 9.'; Chengwei Liu, 'Remedies for Non-performance: Perspectives from CISG, UNIDROIT Principles & PECL' (September 2003) para 2.2 <<http://cisgw3.law.pace.edu/cisg/biblio/chengwei.html> > accessed 21 August 2015.

<sup>8</sup> John Honnold, *Uniform Law for International Sales under the 1980 United Nations Convention* (3<sup>rd</sup> edn, Kluwer 1999) 19; Peter Schlechtriem, *Uniform Sales Law: The UN-Convention on Contracts for the International Sale of Goods* (Manz 1986) 75, 84.

<sup>9</sup> Will (n 4) 331.

<sup>10</sup> Jürgen Basedow, 'Towards a Universal Doctrine of Breach of Contract: The Impact of the CISG' (September 2005) 25 *International Review of Law and Economics* 487, 490; Peter Schlechtriem and Ingeborg Schwenzer, 'Introduction' in Ingeborg Schwenzer (ed), *Schlechtriem and Schwenzer, Commentary on the UN Convention on the International Sale of Goods (CISG)* (3<sup>rd</sup> edn, Oxford University Press 2010) 5.

<sup>11</sup> Robert Koch, 'The Concept of Fundamental Breach of Contract under the United Nations Convention on Contracts for the International Sale of Goods (CISG)' (1999) *Review of the Convention on Contracts for the International Sale of Goods (CISG)* 177, 261.

<sup>12</sup> An example of this is the reduction in price.



apply only for breach of instalment contracts.<sup>13</sup> Although the Convention does not regulate these remedies as part of the general provisions for any failure to perform, it does not make it clear to the merchant what proper consequences would result for breach of certain obligations. Accordingly, apart from avoiding via *Nachfrist*, the remedies laid down in the Convention are theoretically the same for all different types of breach.<sup>14</sup> However, decisive requirements for breach may be required for potential remedial action to take place.<sup>15</sup> The remedy of avoidance, for example, will only be available under certain conditions where the breach of contract is considered to be fundamental<sup>16</sup> or under avoiding procedures of *Nachfrist*.<sup>17</sup> From a practical perspective, it would be more understandable for merchants to identify a number of failures to perform and match them to their proper remedies, at least for self-help remedies such as avoidance of contract.

### **1.1.2 Absence of the notion of fault as to the remedy of damages**

The CISG acknowledges the uniform notion of a breach as a basis of the Convention's liability in damages:<sup>18</sup> the *failure to perform*, without fault.<sup>19</sup> The Convention rejects the notion that one who fails to perform his contract is not responsible in damages unless he has been negligent.<sup>20</sup> If a party to the sale contract fails to perform any of his obligations, assuming that the injured party has suffered some loss, the damages are available independent

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<sup>13</sup> Article 73(3) CISG provides that: 'A buyer who declares the contract avoided in respect of any delivery may, at the same time, declare it avoided in respect of deliveries already made or of future deliveries if, by reason of their interdependence, those deliveries could not be used for the purpose contemplated by the parties at the time of the conclusion of the contract.'; Schlechtriem (n 8) 75.

<sup>14</sup> Basedow (n 10) 490.

<sup>15</sup> Peter Schlechtriem, *Uniform Sales Law: The Experience with Uniform Sales Laws in the Federal Republic of Germany* (Juridisk Tidskrift 1991) 22.

<sup>16</sup> Article 25 CISG (n 5); Schlechtriem and Schwenzler (n 10) 6.

<sup>17</sup> Articles 49(b) and 64(b) CISG (n 5).

<sup>18</sup> Article 45(1)b, Article 61(1)b CISG constitute the very source of the injured party's right to claim damages. Articles 74–77 state how damages are to be measured; Honnold (n 8) 377.

<sup>19</sup> Joseph Lookofsky, 'The 1980 United Nations Convention on Contracts for the International Sale of Goods' in J Herbots and R Blanpain (eds), *International Encyclopaedia of Laws - Contracts*, Suppl 29 (Kluwer 2000) 115.

<sup>20</sup> Honnold (n 8) 301.

of any fault<sup>21</sup> unless the breach was because of an impediment.<sup>22</sup> Here, the Convention follows the common law approach whereby any objective failure on the part of the seller to fulfil any of his obligations provides the buyer with a claim for damages.<sup>23</sup> It has been thought that damage liability without fault is more appropriate for international trade since it provides necessary straight-lined rules to a uniform law without the confusions and exceptions inherent in the ‘fault’ principle.<sup>24</sup>

### **1.1.3 Breach and suspension of performance**

Article 71 CISG expressly permits a seller or a buyer to suspend performance of his own obligations under the sales contract when it becomes apparent that the other party will not perform a substantial part of his obligations.<sup>25</sup> However, the breach may not be sufficient in some circumstances for a party to suspend the performance of his obligations. In such a case, the suspending party will breach the contract when he fails to perform his obligations. The right to suspend performance exists until the time for performance is due.<sup>26</sup> However, once the conditions for suspension no longer exist or the date for performance has passed, the aggrieved party must look to other remedies under the Convention.<sup>27</sup> There may be, for example, a need to avoid the existing contract so that another contract can be expeditiously entered into or so that uncertainty with respect to financial commitments can be removed. The contract and the Convention may require other preliminary steps leading to final

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<sup>21</sup> Will (n 4) 331; Lookofsky (n 19) 115; Markus Muller-Chen, ‘Commentary on Article 45’ in *Schlechtriem & Schwenger* (n 10) 693.

<sup>22</sup> Article 79(1) CISG (n 5) provides that: ‘A party is not liable for a failure to perform any of his obligations if he proves that the failure was due to an impediment beyond his control and that he could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences.’

<sup>23</sup> Will (n 4) 331.

<sup>24</sup> Ernst Rabel, ‘A Specimen of Comparative Law: The Main Remedies for the Seller’s Breach of Warranty’ (1953) 22 *Revista Juridica de la Universidad de Puerto Rico* 167, 180ff; Honnold (n 8) 303 at footnote no 2.

<sup>25</sup> Article 71(1) CISG (n 5).

<sup>26</sup> *Roller Bearings Case* ICC Arb Case No 9448 (July 1999).

<sup>27</sup> UNCITRAL, *Digest of Case Law on the United Nations Convention on the International Sale of Goods* (United Nations 2012).

performance, such as shipping arrangements,<sup>28</sup> handing over of documents,<sup>29</sup> and required steps such as establishing a letter of credit<sup>30</sup> and supplying specifications for goods.<sup>31</sup> Failure to take these steps may also constitute a breach of contract sufficiently serious to justify suspending performance and avoidance.<sup>32</sup>

#### 1.1.4 Breach and impediment

The CISG conception of the breach seems to extend beyond the conception of the breach in strict liability regimes in which the supervening hardship is a permissible excuse for non-performance.<sup>33</sup> According to Article 79 CISG, the failure to perform due to an impediment beyond the parties' control may result in a breach of contract which entitles the innocent party to exercise any right under the Convention other than to claim damages.<sup>34</sup>

The question may arise whether the failure to perform due to an impediment has any particular effect on the availability of avoidance. The avoidance of the contract will only be available on its election by the innocent party. If the impediment results in fundamental breach, the innocent party must first declare his avoidance or set an additional period (*Nachfrist*) after the expiry of which he may avoid if performance remains outstanding. The

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<sup>28</sup> Article 32 CISG (n 5).

<sup>29</sup> Article 34 CISG (n 5).

<sup>30</sup> Article 54 CISG (n 5).

<sup>31</sup> Article 65 CISG (n 5).

<sup>32</sup> Articles 49(1)(a), 64(1)(a)) CISG or a *Nachfrist* notice Articles 47(1), 63(1) CISG; See also Honnold (n 8) 426-436, 427; Chengwei Liu, 'Suspension Or Avoidance Due To Anticipatory Breach: Perspectives From Articles 71/72 CISG, The Unidroit Principles, PECL and Case Law' (2<sup>nd</sup> edn, May 2005) <<http://www.CISG.law.pace.edu/CISG/biblio/liu9.html>> accessed 21 July 2015.

<sup>33</sup> In English law, for example, there is no breach of contract when non-performance of contract is justified by some lawful excuse such as an extraneous event occurs which interferes so seriously with its performance that both parties are discharged under the doctrine of frustration. GH Treitel, *The Law of Contract* (10<sup>th</sup> edn, Sweet & Maxwell 1999) 775.

<sup>34</sup> Article 79(5) CISG (n 5), which deals with impediments to performance beyond the parties' control provides that 'Nothing in this article prevents either party from exercising any right other than to claim damages under this Convention.' It is understood that specific performance cannot be claimed as well due to the impediment.'

impediment does not bring the contract to an end automatically.<sup>35</sup> Therefore, it has been said that the Convention opts for an unfamiliar notion of the breach of contract in both common law and civil law systems<sup>36</sup> in the way that it encompasses those failures to perform which are excused by an impediment beyond the parties' control.<sup>37</sup>

### 1.1.5 No grace period to be granted by tribunal to cure the breach

The period of grace is a judicial intervention that grants the breaching party additional time to perform his obligation or to cure his defective performance. This principle was laid down in the French Civil Code,<sup>38</sup> and from there it was adopted by a number of national laws. It is also known under Islamic systems in limited cases of late payment of monetary obligations by insolvent debtors (both civil and merchant debt).<sup>39</sup> The grace period (*délai de grâce*) of

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<sup>35</sup> Jacob S Ziegel and Claude Samson, 'Report to the Uniform Law Conference of Canada on Convention on Contracts for the International Sale of Goods' (July 1981) comment on paragraph (1) of Article 79 CISG para 3 <<http://www.CISG.law.pace.edu/CISG/text/ziegel79.html>> accessed 21 July 2015.

<sup>36</sup> The traditional view among contract scholars is that civil law systems opt for fault liability in contract law while common law systems opt for strict liability. However, recent research argues that the common denominator between civil and common law systems is that all systems opt for a nuanced combination of the two. See Stefan Grundmann, 'The Fault Principle As The Chameleon Of Contract Law: A Market Function Approach' (June 2009) 107(8) Michigan Law Review 1583, 1586.

<sup>37</sup> Under English law, a frustration dissolves the parties' rights under the contract, and thus any claim to breach and damages. Darren Peacock, 'Avoidance and the Notion of Fundamental Breach under the CISG: An English Perspective' (2003) 8 International Trade and Business Law 95, 101.

<sup>38</sup> The last part of Article 1184 of the French Civil Code 1804 provides that the resolution must be applied for in court, and the defendant may be granted time according to circumstances: '*La condition résolutoire est toujours sous-entendue dans les contrats synallagmatiques, pour le cas où l'une des deux parties ne satisfera point à son engagement. Dans ce cas, le contrat n'est point résolu de plein droit. La partie envers laquelle l'engagement n'a point été exécuté, a le choix ou de forcer l'autre à l'exécution de la convention lorsqu'elle est possible, ou d'en demander la résolution avec dommages et intérêts. La résolution doit être demandée en justice, et il peut être accordé au défendeur un délai selon les circonstances.*' French Civil Code (créé par Loi 1804-02-07, promulguée le 17 février 1804). For comments on this article see GH Treitel, *Remedies for Breach of Contract: A Comparative Account* (Clarendon Press 1988) 323ff; Barry Nicholas, *The French Law of Contract* (Clarendon Press 1992) 241ff.

<sup>39</sup> The Holy Quran recites: 'One who faces hardship in paying his debts must be given time until his financial condition improves. Would that you knew that waiving such a loan as charity would be better for you!' (2:280), Mohammed Sarwar (tr) <<http://www.najaf.org/english/book/25/2.htm>> accessed 20 August 2014. For comprehensive commentary on this verse see Tafsir Al-Mizan By Allamah Muhammad Hussein Tabatabai <<http://www.shiasource.com/al-mizan/tafsir/2-275-281/>> accessed 20 August 2014; parallel multiple translations and commentaries of the Holy Quran are available on the useful website created by volunteers and the open source Muslim community online <<http://quran.com>> accessed 20 August 2014. For Islamic Bankruptcy Law, see Abed Awad and Robert E Michael, 'Ifilas and Chapter 11: Classical Islamic Law and

French origin presupposes a procedure of applying to a court in order to permit the debtor more time to perform his obligation. Obviously, such judicial intervention is intended to preserve the contract from being avoided for breach. However, Articles 45(3) CISG and Article 61(3) CISG prevent recourse to tribunals for a ‘period of grace’ for performance.<sup>40</sup> The procedure of period of grace is impractical for international trade because it could ‘expose the parties to the broad discretion of a judge who would usually be of the same nationality as one of the parties’.<sup>41</sup> It seems that the reasons against such a period of grace are even stronger than the reason to preserve the contract of international sales: ‘Who can sit and wait until the judge or arbiter decides whether to allow immediate avoidance of the contract, or to grant a period of grace?’.<sup>42</sup> Moreover, the avoidance under the Convention was intended to take place immediately by mere declaration of the aggrieved party either for the reason of fundamental breach or after setting *Nachfrist* procedures. Therefore, there is no room for such an additional period under the CISG. The CISG’s express rejection of a grace period provides an unequivocal answer to the conflict between Articles 48 and 49 CISG and whether curable breach can be fundamental.<sup>43</sup>

## **1.2 The grounds for avoidance**

### **1.2.1 ULIS**

The provisions of avoidance under ULIS include similar termination rules to the ones found in CISG, such as the doctrines of fundamental breach, additional time notice, and anticipatory breach and instalment contracts. The avoidance is exercised by the unilateral will of the aggrieved party without the interference of the court. However, the system adopted in the

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Modern Bankruptcy’ (2010) 44 International Lawyer 975; Jason J Kilborn, ‘Foundations of Forgiveness in Islamic Bankruptcy Law: Sources, Methodology, Diversity’ (2011) 85 American Bankruptcy Law Journal 323.

<sup>40</sup> Honnold (n 8) 303; Will (n 4) 332;

<sup>41</sup> United Nations, ‘Commentary on the Draft Convention on Contracts for the International Sale of Goods prepared by the Secretariat’ (Secretariat Commentary) UN Doc A/CONF. 97/5, I, 39; Will (n 4) 332.

<sup>42</sup> Will (n 4) 332; Schlechtriem (n 8) 75.

<sup>43</sup> See part two of this thesis.

1964 Hague Convention differs from the 1980 Vienna Convention. The ULIS provisions on avoidance are spread over many articles.<sup>44</sup> There are two forms of avoidance: the first is the declared avoidance, and the second is *ipso facto* avoidance. The right to declare a contract avoided could be exercised by the aggrieved party when the breach of the contract was fundamental.<sup>45</sup> *Ipsa facto* avoidance took place in specific situations of non-performance without preliminary formal steps.<sup>46</sup>

## **1.2.2 UNIDROIT Principles and PECL**

Both the UNIDROIT Principles and the PECL offer the aggrieved parties remedial measures to terminate any future performance of contract as a result of breach. The termination is the counterpart remedy of avoidance and it is available under three grounds: fundamental non-performance, anticipatory non-performance, termination after expiry of additional period for performance.

### **1.2.2.1 Fundamental non-performance**

Both Article 7.3.1(1) UNIDROIT Principles and Article 9:301(1) PECL provide for the termination of contract where the failure of the other party to perform an obligation under the contract amounts to a fundamental non-performance.

### **1.2.2.2 Anticipatory non-performance**

Both Article 7.3.3 UNIDROIT Principles and Article 9:304 PECL provide for the right of termination where prior to the date for performance by one of the parties it is clear that there will be a fundamental non-performance by that party.

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<sup>44</sup> Articles 25, 26(1),(2), 30(1),(2), 61(1),(2) and 62(1) ULIS (n 1); Anna Kazimierska, 'The Remedy of Avoidance under the Vienna Convention on the International Sale of Goods' [1999-2000] Pace Review of the Convention on Contracts for the International Sale of Goods 79, 86.

<sup>45</sup> *ibid* 87.

<sup>46</sup> Articles 26, 61 and 62 ULIS (n 1).

### 1.2.2.3 Termination after expiry of additional period for performance

Both Article 7.1.5(3) UNIDROIT Principles and Article 9:301(2) PECL provide for the right to terminate the contract for non-fundamental delay after fixing an additional period of time of reasonable length at the end of which the aggrieved party may terminate the contract. The aggrieved party may, in its notice, provide for automatic termination of contract by the end of that period if the other party fails to perform within the period allowed by the notice.

### 1.2.3 CISG

The Vienna Convention abolishes the concept of *ipso facto* avoidance found in the ULIS remedial provisions.<sup>47</sup> Automatic or *ipso facto* avoidance was not included in the remedial system of this Convention because it led to uncertainty as to whether the contract was still in force or whether it had been *ipso facto* avoided.<sup>48</sup> Under the CISG,<sup>49</sup> avoidance is the one-sided right of a party to terminate the contract by mere declaration upon the other party's failure to perform.<sup>50</sup> Such termination might be rightfully based on one of two separate grounds. The first ground is for the aggrieved party to establish a fundamental breach of contract that can be attributed to the other party and the second ground is to fix an additional

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<sup>47</sup> The most important and welcome two differences between ULIS and CISG are the abolition of the concept of *ipso facto* avoidance and substitution of an integrated regime of buyer's and seller's remedies for the repetitive and fragmented provisions in ULIS. See Jacob S Ziegel, 'The Remedial Provisions in the Vienna Sales Convention: Some Common Law Perspectives in Nina M Galston & Hans Smit (eds), *International Sales: The United Nations Convention on Contracts for the International Sale of Goods*, (Matthew Bender 1984) chapter 9, 9-1 to 9-43, 9-5.

<sup>48</sup> Victor Knapp, 'Article 64' in CM Bianca and MJ Bonell (eds), *Commentary on the International Sales Law* (Giuffrè 1987) 465, 466; Chengwei Liu, 'Right to Avoidance (Termination): Perspectives from the CISG, UNIDROIT Principles and PECL' (2<sup>nd</sup> edn, May 2005)

<<http://www.CISG.law.pace.edu/CISG/biblio/liu7.html#c14>> accessed 20 August 2015.

<sup>49</sup> Similarly, under UNIDROIT Principles (n 2) article 7.3.1 or PECL (n 3) article 9:301.

<sup>50</sup> Ulrich Magnus, 'The Remedy of Avoidance of Contract under CISG; General Remarks and Special Cases' (2005-06) 25 *Journal of Law and Commerce* 423.

time of reasonable length for the party in breach to perform particular breached obligations, in default of which the aggrieved party may declare the contract avoided.<sup>51</sup>

### **1.2.3.1 Avoidance upon fundamental breach**

The CISG adopts a concept of fundamental breach of contract as a primary mechanism for avoidance by either party<sup>52</sup> in order to serve the purpose of maintaining the international sales contracts from being terminated except in fundamental breach circumstances.<sup>53</sup> The CISG grants the remedy of avoidance upon fundamental breach in five different provisions found in Articles 49, 51, 64, 72 and 73.

#### **1.2.3.1.1 Article 49(1)(a)**

The buyer may declare the contract avoided if the failure by the seller to perform any of his obligations under the contract or this Convention amounts to a fundamental breach of contract.<sup>54</sup>

#### **1.2.3.1.2 Article 51(1)**

Following the same logic of Article 49, Article 51(1) provides that a part of the contract may be subject to the remedy of avoidance in case of fundamental breach of partial non-conformity and partial delivery. However, the buyer may seek recourse to any remedies provided in Articles 46 to 50 CISG in respect of the part which is missing or which does not conform. Against this background, Article 51(2) sets out the general rule in case of partial

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<sup>51</sup> Pilar Perales Viscasillas, 'The Nachfrist Remedy' in 'Celebrating Success: 25 Years United Nations Convention on Contracts for the International Sale of Goods' (Collation of Papers at UNCITRAL- SIAC Conference, Singapore, 22-23 September 2005) (Singapore International Arbitration Centre) 89, 91; Honnold (n 8) 327.

<sup>52</sup> Peacock (n 37) 98.

<sup>53</sup> UG Schroeter, 'Article 25' in *Schlechtriem and Schwenzler* (n 10) para 7, 403.

<sup>54</sup> CISG (n 5) article 49(1)(a) is substantively identical to 1978 Draft article 45(1)(a) <<http://www.cisg.law.pace.edu/cisg/1978draft.html>> accessed 20 July 2014.



defective performance: partial default does not entitle the buyer to avoid the entire contract unless the partial non-performance or partial non-conformity represents a fundamental breach of the entire contract.<sup>55</sup>

#### **1.2.3.1.3 Article 64(1)(b)**

The seller may declare the contract avoided if the failure by the buyer to perform any of his obligations under the contract or this Convention amounts to a fundamental breach of contract.<sup>56</sup> There is no reference to the seller's right to partial avoidance of the contract in case of partial performance, in parallel with Article 51 CISG. The principle of preserving the contract may provide a solution in such a case. Therefore, the seller is not entitled to avoid the entire contract unless the partial failure by the buyer represents a fundamental breach of the entire contract.

#### **1.2.3.1.4 Article 72(1)**

This provision provides for avoidance based on anticipatory breach: the Convention provides treatment for the consequences of anticipatory breach.<sup>57</sup> The injured party may avoid the contract if prior to the date for performance of the contract it is clear that the other party will commit a fundamental breach of contract.<sup>58</sup> This rule is based on the notion that a party to a contract cannot reasonably be expected to continue to be bound by the contract once it is anticipated, to some extent, that the other party cannot or will not perform at the due date.<sup>59</sup>

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<sup>55</sup> Lookofsky (n 19) 127.

<sup>56</sup> CISG (n 5) article 64(1)(a) is substantively identical to 1978 Draft article 60(1)(a) <<http://www.cisg.law.pace.edu/cisg/1978draft.html>> accessed 20 July 2014.

<sup>57</sup> Ziegel (n 47) 9-35.

<sup>58</sup> Article 72 CISG (n 5) provides that: '(1) If prior to the date for performance of the contract it is clear that one of the parties will commit a fundamental breach of contract, the other party may declare the contract avoided. (2) If time allows, the party intending to declare the contract avoided must give reasonable notice to the other party in order to permit him to provide adequate assurance of his performance.(3) The requirements of the preceding paragraph do not apply if the other party has declared that he will not perform his obligations.'

<sup>59</sup> Liu (n 32) para 3.1.

This right is restricted. The party that intends to declare the contract avoided must give reasonable notice to the other party, whose breach is presumed, in order to permit him to provide adequate assurance of his performance and prevent the avoidance.<sup>60</sup> The failure of the breaching party to provide adequate assurance of performance or to comply with the notice is a condition for the validity of avoidance. However, as the notice must be reasonable there is no need to notify the breaching party in cases where he has already declared that he will not perform the contract or if the assurances could not be procured in time.<sup>61</sup>

### **1.2.3.1.5 Article 73**

Article 73 deals with the effect of a fundamental breach in a contract of sale by instalments. If a fundamental breach is committed with respect to a single instalment, the general rule is that the contract may be avoided only with respect to that single instalment in question and to the relevant obligations of the other party corresponding to it.

However, the contract may also rightfully be avoided in future instalments as well as in the earlier conforming instalments.<sup>62</sup> Paragraph (2) of Article 73 CISG provides that the aggrieved party may be empowered to avoid the contract with respect to future performance if a breach of one instalment indicates the probability of a breach of instalment obligations not yet due.<sup>63</sup> This provision is concerned with the seller's or buyer's failure to perform any of his obligations in respect of any instalment if the failure gives the other party 'good grounds' to conclude that a fundamental breach of contract will occur with respect to future

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<sup>60</sup> Article 72(2) CISG (n 5); ULIS allows avoidance for anticipatory breach without any further action (Art 75 ULIS n 1);

<sup>61</sup> Article 72(3) CISG (n 5); Schlechtriem (n 8) 95.

<sup>62</sup> Ziegel and Samson (n 35) comment on paragraph that comments on article 73(3) CISG <<http://www.cisg.law.pace.edu/cisg/wais/db/articles/english2.html>> accessed 20 July 2014.

<sup>63</sup> 'If one party's failure to perform any of his obligations in respect of any instalment gives the other party good grounds to conclude that a fundamental breach of contract will occur with respect to future instalments, he may declare the contract avoided for the future, provided that he does so within a reasonable time.' Honnold (n 8) 433.

instalments. The other party may declare the contract avoided for the future provided that he does so within a reasonable time.<sup>64</sup>

Paragraph (3) of Article 73 CISG contains a special rule regarding a buyer's avoidance right in the case of an instalment contract. The avoidance envisaged by paragraph (3) here extends to goods that are free from defect and can apply to goods that have been received without objection:<sup>65</sup>

A buyer who declares the contract avoided in respect of any delivery may, at the same time, declare it avoided in respect of deliveries already made or of future deliveries if, by reason of their interdependence, those deliveries could not be used for the purpose contemplated by the parties at the time of the conclusion of the contract.<sup>66</sup>

Honnold provides an example to illustrate instalment interdependency:

A sales contract called for Seller to deliver one machine in January, a second in February, and a third in March. The three were designed to perform a series of interrelated production operations; none of the machines was compatible with machines made by other manufacturers. In January, Seller delivered a machine that conformed with the contract but the machine delivered in February was so defective that the Seller could not cure the defect. Replacement with a second machine was not possible.

Although the buyer accepted the instalment delivered in January, he could not use it for its intended purpose due to the interdependence of the instalments, and the defective or failed performance made the other instalments worthless. Therefore, those instalments could be avoided as well. The entire instalments contract could be rightfully avoided, based on interdependence with a defective instalment, only if the buyer's interest in receiving complete performance was recognizable to the seller at the time of the conclusion of the contract.<sup>67</sup>

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<sup>64</sup> Lookofsky (n 19) 151.

<sup>65</sup> Honnold (n 8) 444.

<sup>66</sup> Article 73(3) CISG (n 5).

<sup>67</sup> Schlechtriem (n 8) 96.

The rules of Article 73 are concerned with successive ‘deliveries’, not instalment payments. However, it can be extended by the *favor contractus* interpretation to missed payments if they coincide with instalment deliveries. Otherwise, the entire contract may be avoided under Article 72.<sup>68</sup>

### **1.2.3.2 Avoidance upon fruitless expiry of *Nachfrist***

The remedy of avoidance upon fruitless expiry of *Nachfrist* is another possibility for avoiding the contract and constitutes an alternative to the fundamental breach ground. However, its application is restricted to three different situations: non-delivery by the seller; buyer’s failure to pay the price; and buyer’s failure to take delivery of the goods. In all other breaches, setting the *Nachfrist* in accordance with Articles 47(1) or 63(1) CISG will not entitle the aggrieved party to avoid the contract, and establishing a fundamental breach of contract is required to rightfully declare avoidance.<sup>69</sup> The CISG grants the *Nachfrist* avoidance<sup>70</sup> in two different provisions: Article 49(1)(b) and Article 64(1)(b).

#### **1.2.3.2.1 Article 49(1)(b)**

Article 49(1)(b) CISG<sup>71</sup> provides that the buyer may declare the contract avoided where the seller has failed to deliver the goods within the additional period of time fixed by the buyer in accordance with paragraph (1) of Article 47 or declares that he will not deliver in the period so fixed.

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<sup>68</sup> *ibid* 96.

<sup>69</sup> Tobias Plate, ‘The Buyer’s Remedy of Avoidance under the CISG: Acceptable from a Common Law Perspective?’ (2002) 6 *Vindobona Journal of International Commercial Law and Arbitration* 57, 67.

<sup>70</sup> CISG also provides for a general remedy of *Nachfrist* in articles 47 and 63.

<sup>71</sup> CISG Article 49 provides that ‘(1) The buyer may declare the contract avoided: ... (b) in case of non-delivery, if the seller does not deliver the goods within the additional period of time fixed by the buyer in accordance with paragraph (1) of article 47 or declares that he will not deliver within the period so fixed’. For the counterpart of this article in other instrument See: Article 7.1.5 (3) UNIDROIT (n 2); Article 9:301(2) PECL (n 3).

Delay in delivery does not necessarily constitute, by itself, a fundamental breach that gives the buyer the right to avoid the contract. If the circumstances make any delay in delivery a fundamental breach (as when prices for the goods are subject to sharp fluctuations), the buyer may avoid the contract under paragraph (1)(a) without giving additional time to the seller. However, at times, the buyer may have reason to doubt that a delayed delivery by the seller amounts to a 'fundamental' breach under Article 49(1)(a); in that case, it is advisable for the buyer to fix an additional period of time for the seller to perform his obligation in accordance with Article 47(1) CISG. If the seller fails to do so or declares that he will not perform within the fixed period, the buyer may rightfully declare avoidance without having to consider whether the total delay has reached 'fundamental' proportions.<sup>72</sup>

#### **1.2.3.2.2 Article 64(1)(b)**

Article 64(1)b<sup>73</sup> provides that the seller may declare the contract avoided where the buyer does not perform his obligation to pay the price or take delivery of the goods within the additional period of time fixed by the seller in accordance with paragraph (1) of Article 63 or if he declares he will not do so within the period so fixed. Payment and taking delivery are considered such fundamental obligations that their breach should entitle the seller to avoid the contract. As can be seen from the above, these two routes do not run parallel; in fact, they are often interchangeable and in some circumstances both routes of avoidance may be available.

The grounds for avoidance of international sales contracts under the CISG can be summarized in three categories:

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<sup>72</sup> Lookofsky (n 19) 125; Will (n 4) para 2.1.3, 363; Honnold (n 8) 329; Plate (n 69) 67.

<sup>73</sup> CISG Article 64 provides that '(1) The seller may declare the contract avoided: ... (b) if the buyer does not, within the additional period of time fixed by the seller in accordance with paragraph (1) of article 63, perform his obligation to pay the price or take delivery of the goods, or if he declares that he will not do so within the period so fixed'. For the counterpart of this article in the other instruments see: Article 7.1.5 (3) UNIDROIT (n 2); Article 9:301(2) PECL (n 3).

- 1- Avoidance for (actual) fundamental breach by the aggrieved party, whether a buyer or seller. The aggrieved party may be allowed to avoid part of the contract in cases of partial fundamental breach. The aggrieved party is not allowed to avoid the entire contract unless the partial non-performance represents a fundamental breach of the entire contract.
- 2- Avoidance for anticipatory breach.
- 3- Avoidance after fruitless expiry of *Nachfrist*.

The Convention, unlike ULIS, does not provide for automatic avoidance of contract. The CISG approach has been adopted by other unification projects, such as the UNIDROIT Principles and PECL.

### **1.3 Conclusion**

The CISG provide a unique system for avoidance of contract. This system is different to the systems provided in the ULIS or in domestic laws. The CISG introduces a uniform concept of breach of any obligation. There is no distinction between various types of contractual obligations upon breach of which the avoidance of contract would certainly be available. The Convention recognizes the special characteristics of the international trade environment where the parties are from different jurisdictions and where, typically, the sale of goods is costly and is linked to several contracts, such as carriage of goods, insurance, letter of credit or resale agreements. Therefore, the Convention favours the preservation of the contract wherever possible. The Convention restricts the aggrieved party's right to avoid the contract only when the breach is fundamental or via special procedures of *Nachfrist* for certain breaches of late delivery by the seller or late payment and taking delivery by the buyer. Although avoidance of contract should not be granted easily, it is important to protect the interests of the aggrieved party by recognizing his right to avoidance if the breach is

fundamental. The Convention provides the aggrieved party with a right to discharge himself from the contract by mere declaration of avoidance without a need for judicial intervention. In addition, the right to avoidance cannot be defeated by recourse to tribunals for a 'period of grace' for performance even if it was certain that granting such additional time would cure late performance. Exercising the right to avoid the contract under international sales law is subject to formal requirements which weigh up conflicting considerations. Avoidance can only be effected by a notice declared to the breaching party within a reasonable time. This requirement of notice in a reasonable time will be discussed in the next two chapters.

## **Chapter Two: The rules on the notice to the defaulting party**

Under the Convention, the aggrieved party may avoid the contract by informing the breaching party that the contract has been declared avoided. A declaration of avoidance must be made through a notice to the defaulting party. The aggrieved party does not have to bring an action in court in order to have the contract avoided. This chapter will address the rules on giving notice to the breaching party to understand why such notice is important.

### **2.1 The general rules**

The notice to avoid the contract constitutes a crucial component of the avoidance mechanism under the Convention. A properly issued notice will safeguard a party's ability to seek avoidance of the contract. In contrast, an imperfect notice may render avoidance ineffective.<sup>1</sup>

Article 26 CISG is a general provision that relates to the right of the injured party (seller or buyer) to avoid the contract.<sup>2</sup> It provides that, '[a] declaration of avoidance of the contract is effective only if made by notice to the other party'. A single notice will suffice. The Convention does not require a 'warning' notice that declares in advance the injured party's intention to avoid.<sup>3</sup> The Convention, however, does not elaborate beyond this general provision in terms of the proper issuance of a notice. Therefore, several considerations associated with the notice requirement arise, specifically, whether the notice must be communicated explicitly or whether it can be accomplished through implicit conduct and whether the notice of avoidance is irrevocable or whether it can be withdrawn or revoked.<sup>4</sup>

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<sup>1</sup> Christopher M Jacobs, 'Notice of Avoidance under the CISG: A Practical Examination of Substance and Form Considerations the Validity of Implicit Notice and the Question of Revocability' (2003) 64 *University of Pittsburgh Law Review* 407, 428.

<sup>2</sup> Joseph Lookofsky, 'Article 26; When Avoidance Declaration Effective' in J Herbots and R Blanpain (eds) *International Encyclopaedia of Laws: Contracts*, Suppl 29 (Kluwer Law International 2000) 79.

<sup>3</sup> *ibid* 80.

<sup>4</sup> Jacobs (n 1) 407.



The requirements of notice also exist under other unification projects, including the UNIDROIT Principles,<sup>5</sup> PECL<sup>6</sup> and CESL.<sup>7</sup> The commentaries made for these projects provide a helpful contribution to the reasoning behind the notice requirement under CISG.<sup>8</sup>

### 2.1.1 Practical considerations

A declaration of avoidance through notice to the defaulting party is a general requirement applicable to all types of avoidance whether the avoidance is because of a fundamental breach or after the breaching party's failure to duly comply with a reasonable *Nachfrist* notice. The avoiding party must declare the notice to the defaulting party in case of partial avoidance, anticipatory avoidance and instalment. The notice is required in order to ensure that the defaulting party is aware of the status of the contract. Uncertainty as to whether the aggrieved party will accept performance or not may often cause a loss to the defaulting party which is disproportionate to the inconvenience which the aggrieved party will suffer by giving a notice. There is no room for *ipso facto* avoidance under the Convention and the breaching party may rightfully conclude that the aggrieved party will accept the delayed or defective performance in the absence of such notice.<sup>9</sup> Such a position guarantees more

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<sup>5</sup> Article 7.3.2(1) UNIDROIT Principles provides: 'The right of a party to terminate the contract is exercised by notice to the other party.' UNIDROIT, *Principles of International Commercial Contracts* (3<sup>rd</sup> edn, 2010).

<sup>6</sup> PECL Article 9:303(1), which reads: 'A party's right to terminate the contract is to be exercised by notice to the other party.' Commission on European Contract Law, *Principles of European Contract Law* (Parts I and II revised 1998, Part III 2002).

<sup>7</sup> Article 120 CESL: 'A right to terminate under this Section is exercised by notice to the seller'; Article 141: 'A right to terminate under this Section is exercised by notice to the buyer'; Article 118: 'A right to terminate under this Section is exercised by notice to the seller.' Commission, 'Proposal for a Regulation of the European Parliament and of the Council on a Common European Sales Law (CESL)' COM (2011) 635 final.

<sup>8</sup> Article 7 CISG offers the possibility of interpreting the Convention in the light of other unification projects. United Nations Convention on Contracts for International Sale of Goods (11 April 1980, entered into force 1 January 1988) 1489 UNTS 3 (CISG/Vienna Convention/The Convention).

<sup>9</sup> See 'Comment on Article 7.3.2 UNIDROIT Principles', comment 1 <<http://www.cisg.law.pace.edu/cisg/principles/uni26.html>> accessed 21 January 2014; 'Comment and Notes to PECL Article 9:303', comment A <<http://www.cisg.law.pace.edu/cisg/text/peclcomp26.html>> accessed 20 January 2015; Chengwei Liu, 'Declaration Of Avoidance: Perspectives from the CISG, UNIDROIT Principles and PECL and case law' (2nd edn, June 2005) para 5 <<http://www.cisg.law.pace.edu/cisg/biblio/liu10.html>> accessed 20 January 2015.

stability in the relations between the seller and the buyer. If an injured party does not declare the contract avoided, it remains valid despite fundamental breach.<sup>10</sup>

### **2.1.1.1 Form**

#### **2.1.1.1.1 The general principle of freedom of form**

The declaration of avoidance is not subject to any requirements as to form. In accordance with the general principle of freedom-from-form requirements, as established in Article 11 CISG,<sup>11</sup> the notice need not be given in any particular form.<sup>12</sup> Therefore, a valid notice can be made in writing or even orally. Written notice may be given in different ways as long as they serve to inform the breaching party of the end of the contract. The statement of claim filed with the court suffices to replace the declaration of avoidance.<sup>13</sup>

The non-written notices, such as oral or telephone notices, are valid; however, they are difficult to prove. The burden of providing evidence that notice was given is on the avoiding party<sup>14</sup> and if giving notice cannot be proven, the court will not allow the avoiding party to rely on the notice. If the other party does not dispute that a telephone call took place, the

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<sup>10</sup> *Metal Concentrate Case* ICC Arb Case No 8574 (September 1996); *Case 196/1997* Tribunal of International Commercial Arbitration at the Russian Federation Chamber of Commerce and Industry (22 October 1998); *Fabric Case* Appellate Court Bamberg, Germany (13 January 1999); *Case 9978* ICC Arb (March 1999); Liu (n 9) para 5.

<sup>11</sup> Article 11 CISG (n 8): 'A contract of sale need not be concluded in or evidenced by writing and is not subject to any other requirement as to form. It may be proved by any means, including witnesses.'

<sup>12</sup> UNCITRAL, *Digest of Case Law on the United Nations Convention on the International Sale of Goods* (United Nations 2008), Article 11. However, Article 96 CISG (n 8) provides: 'A Contracting State whose legislation requires contracts of sale to be concluded in or evidenced by writing may at any time make a declaration in accordance with article 12 that any provision of article 11, article 29 or Part II of this Convention, that allows a contract of sale or its modification or termination by agreement or any offer, acceptance, or other indication of intention to be made in any form other than in writing, does not apply where any party has his place of business in that State.'

<sup>13</sup> *Roder v Rosedown* Federal District Court Australia (28 April 1995); *Jewelry Case* Supreme Court Austria (28 April 2000).

<sup>14</sup> *Clothes Case* District Court Kassel, Germany (22 June 1995); Jacob S Ziegel and Claude Samson, 'Report to the Uniform Law Conference of Canada on Convention on Contracts for the International Sale of Goods' (July 1981) para comment on Article 27 <<http://www.cisg.law.pace.edu/cisg/text/ziegel27.html>> accessed 20 August 2015.

notice will be deemed valid. If the aggrieved party cannot substantiate the call, consideration should not be given to a telephone communication unless the other party does not dispute that the call occurred.<sup>15</sup> However, the parties may derogate from the general principle of freedom-from-form and require a written notice for any type of notification.<sup>16</sup> Overall, it is advisable for a party to issue the notice of avoidance in writing to ensure that the notice has truly been given if a dispute later arises.<sup>17</sup>

#### **2.1.1.1.2 Implicit notice**

An implicit declaration of avoidance by conclusive conduct has been disputed as a valid notice of avoidance. The fact that a buyer sends back the delivered goods without further explanation does not amount to a valid notice of declaration of avoidance.<sup>18</sup> Similarly, mere purchase by the buyer of substitute goods does not constitute a valid (implicit) notice of declaration of avoidance.<sup>19</sup> Even if an implied declaration of avoidance were possible, the recipient of this declaration must be in the position to realise, beyond doubt, that the aggrieved party has avoided the contract.<sup>20</sup>

However, in certain situations, an explicit declaration of avoidance is unnecessary. To insist on an explicit declaration would be contrary to the principle of good faith as set out in Article 7(1) CISG if the seller had refused to deliver after the expiry of an additional period for

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<sup>15</sup> *Shoes Case* District Court Frankfurt, Germany (9 December 1992)

<<http://CISGW3.law.pace.edu/cases/921209g1.html>> accessed 20 August 2015.

<sup>16</sup> *Wool Case* CIETAC Arbitration Proceeding, China (28 February 2005). The Arbitration Commission noted that the seller had failed to send notice in writing to fix an additional period, which was in contravention of the contract, under whose terms any information sent by one party to the other had to be in written form.

<sup>17</sup> Jacobs (n 1) 428.

<sup>18</sup> *Shoes Case* (n 15).

<sup>19</sup> *Fabric Case* (n 10).

<sup>20</sup> *Shoes Case* (n 15); *Propane Case* Supreme Court, Austria (6 February 1996).

delivery.<sup>21</sup> It would make little sense to expect a party to make a formal declaration of avoidance where the aggrieved party has no option but to treat the contract as avoided.<sup>22</sup>

## **2.1.1.2 Content**

### **2.1.1.2.1 Clarity in the avoidance notice**

An avoidance notice must satisfy high standards of clarity and precision. The aggrieved party should issue a declaration in such a manner that ‘a reasonable party in the breaching party’s position [will be informed] that the contract has been avoided’.<sup>23</sup> It does not matter whether the aggrieved party uses the technical terms ‘avoidance’ or ‘avoid’. Declarations of avoidance may be made using any other terms if it is made clear to the other party that the party entitled to avoidance does not intend to stand by the contract.<sup>24</sup> The declaration must be unambiguous in indicating that the aggrieved party does not wish to keep the contract on foot.<sup>25</sup> In the terms of the tender or delivery of defective goods, avoidance of the contract by the buyer means that the buyer will not accept or keep the goods, and that the seller has the responsibility to take over their disposition. A buyer’s notice of avoidance should clearly indicate to the seller that the buyer would not accept or keep the goods. Conversely, a seller’s notice of avoidance must inform the buyer that the seller will not deliver the goods or, if the goods have been delivered, that the seller demands their return.<sup>26</sup>

The legal consequences of a vague notice depend on the reaction of the breaching party. Only if the breaching party consents to the avoidance of the contract will the contract become

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<sup>21</sup> *Iron Molybdenum Case* Appellate Court Hamburg, Germany (28 February 1997).

<sup>22</sup> Ziegel and Samson (n 14) comment on Article 26; Christiana Fountoulakis, ‘Article 26’ in Ingeborg Schwenzer (ed), *Schlechtriem and Schwenzer, Commentary on the UN Convention on the International Sale of Goods (CISG)* (3rd edn, Oxford University Press 2010) para 8, 442.

<sup>23</sup> *Case 9978* (n 10); Liu (n 9) para 4.

<sup>24</sup> *Case 9978* (n 10); Liu (n 9) para 4.

<sup>25</sup> *Furniture Case* Appellate Court Oldenburg, Germany (28 April 2000).

<sup>26</sup> John Honnold, *Uniform Law for International Sales under the 1980 United Nations Convention* (3rd edn, Kluwer Law International 1999) 213-215.

avoided. If, however, the breaching party disagrees with the clarity of the notice, parties' declarations should be interpreted in conformity with what a reasonable person would have understood in the same circumstances. That is to say, it must be evident to a reasonable person, using the criteria of Article 8 CISG, that the notice in question must clearly express the aggrieved party's wish to avoid the contract as a remedy in consequence of a particular breach.<sup>27</sup>

#### **2.1.1.2.2 Threat to avoid the contract**

Whether the notice is written or given orally, it must be unequivocal in informing that the avoiding party will no longer be bound under the sales contract. The threat of avoidance does not achieve the requisite level of clarity. In a case relating to a contract for the sale of coal,<sup>28</sup> a seller who did not receive the purchase price communicated to the buyer that he would avoid the contract if payment were not received. The court held that the threat of avoidance did not constitute a valid notice of avoidance because the condition regarding the receipt of the purchase price indicated that the seller did not consider the contract avoided.

#### **2.1.1.2.3 The language of the notice**

The notice must be communicated in a language comprehensible to the addressee; otherwise, the purpose of notice requirements may be defeated. The contract between the parties will determine explicitly the language in which communications relating to the contract are to be made. The interpretation of the contract should determine what language the contracting parties contemplated as the language to be used in notices, requests or other such communications.<sup>29</sup> The mere fact that a notice was given in a language that was not the same

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<sup>27</sup> Liu (n 9) para 4.

<sup>28</sup> *Coke Case* Appellate Court Munich, Germany (2 March 1994).

<sup>29</sup> Samuel K Date-Bah, 'Article 27' in CM Bianca and MJ Bonell (eds), *Commentary on the International Sales Law* (Giuffrè 1987) 232.

language as that of the contract, nor that of the addressee, does not cause the notice to be ineffective. The decision in the *Socks* case<sup>30</sup> did not embrace the notice of avoidance but the same approach can apply to the notice embodying the declaration of avoidance as well. In *Socks*, the Court decided the matter by taking into account the understanding of a reasonable person, giving due consideration to usages and practices observed in international trade according to Article 8(2) and Article 8(3) CISG. In this case, the contract was written in Italian. The seller assigned to a bank the right for payment of price. The seller notified the assignment to the buyer with a document written in English and French. The buyer did not pay the price to the bank. The bank commenced action against the buyer, claiming payment of price. The Court held that the foreign language could be the language normally used in the respective trade sector to which the parties may be considered to have agreed upon. If that were not the case, the notice would be effective if the addressee could have reasonably been expected to request from the sender of the notice explanations or a translation.<sup>31</sup>

### **2.1.1.3 Risk of transmission and binding effect**

Article 27 lays the risk of delay, loss or mutilation of the declaration on the addressee once the declaration has been dispatched. This is applicable for all types of declarations made in accordance with Part III of the Convention. It states that if the declaration is given or made by means that are appropriate in the circumstances, a delay or error in the transmission of a communication or its failure to arrive does not deprive that party of the right to rely on the communication. The idea behind this is that the party in breach must bear the risk of transmission of declarations to its contractual partner.

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<sup>30</sup> *Socks Case* Appellate Court Hamm, Germany (8 February 1995).

<sup>31</sup> Anna Kazimierska, 'The Remedy of Avoidance under the Vienna Convention on the International Sale of Goods' [1999-2000] *Pace Review of the Convention on Contracts for the International Sale of Goods* 79, note 432.

#### 2.1.1.4 Effectiveness and revocation of the notice

Unlike the rule applicable to offer declarations set out in Part II of the Convention,<sup>32</sup> the rule in Article 27 does not distinguish between the legal effectiveness of such declarations and their binding nature. It is disputed whether this Article also addresses the question of where the declaration becomes effective.<sup>33</sup> One view suggests that Article 27 CISG assumes that the declaration becomes effective on dispatch.<sup>34</sup> Another view suggests that effectiveness occurs only upon receipt. In the event of loss of the communication, effectiveness occurs at the hypothetical moment of receipt under normal circumstances.<sup>35</sup> The two views have claimed practical results in revoking the notice. The special significance of the effectiveness of the notice dispute is the ability of the declaring party to withdraw or change his declaration at any time prior to the time of receipt if the effectiveness and irrevocability of Article 27 CISG declarations are deemed to coincide.<sup>36</sup>

Another view advanced states that identifying the concepts of effectiveness and irrevocability of notices within the language of Article 27 CISG is inappropriate. Even in the drafting stage, the drafters of the Convention did not address the relationship between the effectiveness and the irrevocability of notices in the language of Article 27 CISG. Effectiveness of a notice to avoid and its irrevocable nature are wholly unrelated. The irrevocability of a notice to avoid ultimately depends on whether the addressee acted in reliance of the declaration, regardless of when the notice actually takes effect. This particular theory suggests that the avoiding party

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<sup>32</sup> Article 15, Article 16 CISG (n 8).

<sup>33</sup> Peter Schlechtriem, 'Effectiveness and Binding Nature of Declarations (Notices, Requests or Other Communications) under Part II and Part III of the CISG' (1995) *Cornell Review of the Convention on Contracts for the International Sale of Goods* (1995) 95, para 3; Fountoulakis (n 22) 443.

<sup>34</sup> Ziegel and Samson (n 14) comment on Article 27.

<sup>35</sup> Victor Knapp, 'Article 64' in Bianca and Bonell (n 29) 468.

<sup>36</sup> Ericson P Kimbel, 'Nachfrist Notice and Avoidance under the CISG' (1999) 18 *Journal of Law and Commerce* 301, 312-13.

maintains a right to revoke the notice to avoid until the addressee becomes aware of the notice.<sup>37</sup>

## **2.1.2 The notice in specific situations**

### **2.1.2.1 Warning notice for anticipatory breach**

According to Article 72 CISG, in case of avoidance for anticipatory breach the party that intends to declare the contract avoided must give reasonable notice to the other party in order to permit him to provide adequate assurances of his performance. Providing for the duty to inform the defaulting party is an instrument that aims to establish clarity and prevent the creditor from prematurely dissociating from the contract. It can be considered as a requirement of contract avoidance the absence of which eliminates the right of avoidance. The debtor will have the opportunity to dispel doubts about its contract loyalty by issuing adequate assurances. If the debtor is able to provide security, there will be no necessity for the creditor to avoid the contract as the proper fulfilment of the contract will usually be restored by receiving adequate assurance.<sup>38</sup>

#### **2.1.2.1.1 Form and content of anticipatory breach notice**

The notice requirement of Article 72(2) must comply with Articles 26 and 27 CISG. The Convention does not prescribe the content of the anticipatory breach notice but it requires the notice to be reasonable. The notice must be issued for a reasonable cause, within a reasonable time, and reasonable terms that give an opportunity to the other party to demonstrate its ability to perform its commitments or to furnish adequate assurance.<sup>39</sup> The notice must

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<sup>37</sup> Schlechtriem (n 33) para 3.

<sup>38</sup> Christiana Fountoulakis, 'Article 72' in *Slechtriem and Schwenger* (n 22) para 15, 974.

<sup>39</sup> Article 72 CISG (n 8) '(1) If prior to the date for performance of the contract it is clear that one of the parties will commit a fundamental breach of contract, the other party may declare the contract avoided. (2) If time allows, the party intending to declare the contract avoided must give reasonable notice to the other party in order



include the nature of the anticipated breach and the reasons that led to anticipate the breach. The notice can also include the sufficient securities required to dispel uncertainty and restore confidence in the defaulting party's ability to perform its obligations.<sup>40</sup>

#### **2.1.2.1.2 Exemptions**

The Convention does not make the avoidance notice for anticipatory fundamental breach a prerequisite in all cases. Paragraphs (2) and (3) of Article 72 CISG recognize the possibility that the contract may be avoided without giving notice to the other party. There are two exemptions from giving the notice. The aggrieved party will be exempted from giving the notice if time does not allow it to do so or if the defaulting party has announced that it will not perform its obligations.

Paragraphs (2) and (3) were added to Article 72 CISG at the Diplomatic Conference after concerns were raised, primarily on behalf of developing countries, that the power of suspension under Article 71 CISG and similarly of avoidance under Article 72 CISG might be abused. The addition of paragraphs (2) and (3) was part of the compromise developed by an ad hoc working group with respect to both Articles 71 and 72 CISG.<sup>41</sup>

##### **2.1.2.1.2.1 If time does not allow direct notification**

The party intending to avoid the contract for anticipatory breach is obliged to give the notice only if time allows it to do so. The Convention does not specify the cases where time would not allow it to give notice, leaving it to the discretion of the aggrieved party himself. In any

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to permit him to provide adequate assurance of his performance. (3) The requirements of the preceding paragraph do not apply if the other party has declared that he will not perform his obligations.'

<sup>40</sup> Khaled Abd El Hamid, 'The Avoidance of the Contract for International Sale of Goods according to the Vienna Convention 1980' (PhD Thesis, Cairo University, 2001) para 213.

<sup>41</sup> Honnold (n 26) 440; Trevor Bennett, 'Article 72' in Bianca and Bonell (n 29) 527; Jelena Vilus, 'Provisions Common to the Obligations of the Seller and the Buyer' in Petar Sarcevic and Paul Volken (eds), *International Sale of Goods: Dubrovnik Lectures* (Oceana 1986) 246.

event, the interpretation of ‘if time allows’ would be consistent with good faith and normal commercial practice and would reduce the risks of making a declaration of avoidance. However, the circumstances in which time would not allow reasonable notice to be given under Article 72(2) CISG seem unlikely to arise frequently. With the means of communication that are now available, it is difficult to imagine circumstances in which some prior notice could not be given. Modern methods of communication would normally permit such a notice without unduly impeding the aggrieved party’s freedom of action.<sup>42</sup> The interpretation of ‘reasonable’ notice in paragraph 72(2) CISG must take into account the time the other party needs in order to respond and provide adequate assurance of its performance.<sup>43</sup> If time does not permit such action, the aggrieved party is allowed to avoid the contract immediately without the need for notice of its intention to do so.

#### **2.1.2.1.2.2 The defaulting party announces that it will not perform its obligations**

There will be no need to provide a warning notice of avoidance if the breaching party announces that it will not perform its obligations.<sup>44</sup> The aggrieved party in this case will be entitled to avoid the contract immediately but it still needs to declare the contract avoided with a notice. The purpose of the warning notice requirement is to enable the other party to provide adequate assurance of his performance. Where it is apparent that the warning notice will be very ineffective, such as in case of definite refusal of the obligor to perform his obligation, then the necessity to give notice clearly lessens. The innocent party does not have to wait and see whether the obligor changes its mind; it can avoid the contract immediately.

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<sup>42</sup> Bennett (n 41) 525; Honnold (n 26) 440; Chengwei Liu, ‘Suspension or Avoidance Due to Anticipatory Breach: Perspectives from Articles 71/72 CISG, the UNIDROIT Principles, PECL and Case Law’ (2nd edn, May 2005) 5.1(a).

<sup>43</sup> Bennett (n 41) 525.

<sup>44</sup> Article 72(3) CISG (n 8).

Furthermore, the declaration of avoidance may be an obligation on the innocent party in the sense of mitigating its loss.<sup>45</sup>

### **2.1.2.2 Notice in case of non-conformity and third party claims**

The notices of non-conformity and third party claims are important in relation to the remedy of avoidance by the buyer. The buyer may lose his right of avoidance that arises from the lack of conformity or third party claims on the goods delivered if he failed to duly notify the seller about the respective breach. Article 39(1) CISG states that the buyer loses the right to rely on a lack of conformity of the goods if he does not give notice to the seller specifying the nature of the lack of conformity, whether that relates to quality, quantity or description as provided by Article 35 CISG. The buyer is also obliged to notify the seller if a third party claims a right to possession or prohibits their use by virtue of a patent or other industrial or intellectual property rights.<sup>46</sup> If the buyer does not notify the seller, he loses his rights to claim damages, to require delivery of substitute goods, to require repair, to fix an additional period for performance, to declare the contract avoided and to reduce the price.<sup>47</sup>

#### **2.1.2.2.1 The form and content requirements concerning the non-conformity notice**

##### **2.1.2.2.1.1 The form**

The notice of lack of conformity is not required to be in a particular form and thus it can be given verbally or by telephone.<sup>48</sup> An oral lack of conformity notice given over the phone is held to be sufficient.<sup>49</sup> In several cases, however, it has been found that the buyer had failed

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<sup>45</sup> Liu (n 42) 5.1(b); Lookofsky (n 2) 151.

<sup>46</sup> Article 43 CISG (n 8).

<sup>47</sup> Article 45 para 1(b), Article 46 para 2, Article 46 para 3, Article 47, Article 49, Article 50 CISG (n 8) respectively; Fritz Enderlein, 'Rights and Obligations of the Seller under the UN Convention on Contracts for the International Sale of Goods' in Sarcevic and Volken (n 41) 133, 171.

<sup>48</sup> *Rheinland Versicherungen v Atlarex* District Court Vigevano, Italy Case No 405 (12 July 2000).

<sup>49</sup> *Shoes case* (n 15).

to prove with sufficient certainty that a compliant notice had been given.<sup>50</sup> Therefore, buyers are always advised to give a written notice to eschew problems concerning evidence. The principle of freedom of form applies unless agreed otherwise in the contract.<sup>51</sup> In *MCC-Marble Ceramic Center v Ceramica Nuova D'Agostino*<sup>52</sup> the buyer was held to have lost his right to rely on an oral notice because of a contractual clause that required complaints about defects in the goods to be in writing and made by certified letter. Where a writing requirement has been agreed, Article 13 CISG will apply which defines 'writing' to include telegram and telex.<sup>53</sup>

#### **2.1.2.2.1.2 The content**

A substantial degree of specificity is required for the non-conformity notice to be compliant. The notice of non-conformity must specify the nature of the lack of conformity. The notice of a third party claim must specify the nature of the right or claim of the third party. The principal function of the notification duty is to enable the seller to obtain and preserve evidence of an alleged breach<sup>54</sup> and, if so, to give the seller the information needed to determine how to proceed in general with respect to the buyer's claim<sup>55</sup> as well as to facilitate

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<sup>50</sup> *ibid.*

<sup>51</sup> *MCC-Marble Ceramic Center v Ceramica Nuova D'Agostino* Federal Appellate Court (11<sup>th</sup> Circuit), United States (29 June 1998). A Contractual clause required complaints of defects in the goods to be in writing and made by certified letter; Ingeborg Schwenzer, 'Article 39' in *Schlechtriem and Schwenzer* (n 22) para 11; Alastair Mullis, 'Examination and notice requirements concerning the conformity of the goods' in Peter Huber and Alastair Mullis (eds), *The CISG: A new textbook for students and practitioners* (Sellier 2007) 156.

<sup>52</sup> *MCC-Marble Ceramic Center* (n 51).

<sup>53</sup> Mullis (n 51) 156 footnote 574.

<sup>54</sup> *Trekking Shoes Case* Supreme Court Austria (27 August 1999); *Tinned Cucumbers Case* Appellate Court Dusseldorf, Germany (8 January 1993); Schwenzer (n 51) para 6, 624-625; Kazuaki Sono, 'Article 39' in Bianca and Bonell (n 29) para 2.3; Mullis (n 51) 157.

<sup>55</sup> See the United Nations, 'Commentary on the Draft Convention on Contracts for the International Sale of Goods prepared by the Secretariat' (Secretariat Commentary) UN Doc A/CONF. 97/5, Article 37, para 4; *Printing System and Software Case* Supreme Court Germany (4 December 1996); *Ice Cream Parlour Furnishings Case* District Court Saarbrücken, Germany (26 March 1996); *Rheinland Versicherungen* (n 48); Honnold (n 26) 278; Mullis (n 51) 157.

the seller's cure of defects.<sup>56</sup> Several court decisions held that the buyer loses the right to rely on non-conformity of the goods if the notifications he sent did not specify precisely the defect in the goods.<sup>57</sup> A notice that simply states that the goods 'do not comply with the contract', 'are not working properly', suffer from 'poor workmanship and improper fitting' or that they are of 'bad quality' is not sufficient.<sup>58</sup> A buyer of some apparel was held to have lost all remedial rights since the notifications allegedly sent to the seller/manufacturer stating 'poor workmanship and improper fitting' did not specify the nature of the alleged non-conformities with sufficient precision.<sup>59</sup> However, with the principle of good faith and in an age of electronic communication, the seller might be expected to inquire if he wanted to know more about the nature of the lack of conformity. The requirements for specifying a lack of conformity should not be exaggerated.<sup>60</sup> It is doubtful, therefore, that it is possible to conclude that such a demanding stance with respect to the specificity of the notice would be applied uniformly and always result in the buyer losing his right of avoidance and other remedies.<sup>61</sup> It is suggested that a more liberal approach to the degree of precision required by Article 39 CISG should now prevail.<sup>62</sup>

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<sup>56</sup> *Rheinland Versicherungen* (n 48); *Shoe Sales Case* District Court Erfurt, Germany (29 July 1998); Mullis (n 51) 157.

<sup>57</sup> *Textiles Case* Appellate Court Frankfurt, Germany (13 June 1991); *Leather Goods Case* Appellate Court Munich, Germany (9 July 1997); *Secondhand Bulldozer Case* Appellate Court Valais, Switzerland (28 October 1997); *Printing System and Software Case* (n 55); *Machine for Producing Hygienic Tissues Case* Supreme Court Germany (3 November 1999); Honnold (n 26) 279; Schwenger (n 51) para 7; Mullis (n 51) 158.

<sup>58</sup> *Catalogue Case* Commercial Court Zürich, Switzerland (21 September 1998); *Computer Software and Hardware Case* Commercial Court Zürich, Switzerland (17 February 2000); *Fashion Textiles Case* District Court München, Germany (3 July 1989); *Namur-Kreidverzekering v Wesco* District Court Kortrijk, Belgium (16 December 1996) respectively.

<sup>59</sup> *Fashion Textiles Case* (n 58); Lookofsky (n 2) 105.

<sup>60</sup> Schwenger (n 51) para 6, 625-626; Mullis (n 51) 158.

<sup>61</sup> In this regard, some of the early case law, particularly decisions from German courts, probably influenced by the requirement in domestic German law to give precise details, should be regarded as suspect; Mullis (n 51) 158.

<sup>62</sup> *Machine for Producing Hygienic Tissues Case* (n 57); *Machinery Case* District Court Busto Arsizio, Italy (13 December 2001); *Packaging Machine Case* Bundesgericht Federal Supreme Court Switzerland (18 May 2009); *Lumber Case* Federal Supreme Court Switzerland (28 May 2002); Schwenger (n 51) para 6; Mullis (n 51) 158.

### 2.1.2.2 Exceptions

There are exceptions, however, to losing the right of avoidance due to the buyers' failure to give notice.<sup>63</sup> Firstly, the buyers' right to a proper examination and consequent notification does not protect the bad faith seller.<sup>64</sup> The bad faith seller is not entitled to rely on the buyers' failure to give notice if the lack of conformity relates to facts of which he knew or could not have been unaware and which he did not disclose to the buyer.<sup>65</sup> The effect of the application of this exception is a complete retention of remedies as the sanction of Article 39 is effectively brushed aside.<sup>66</sup>

Secondly, Article 44 CISG provides that the buyer may reduce the price in accordance with Article 50 CISG or claim damages, except for loss of profit, if it has a reasonable excuse for its failure to give the required notice as to non-conformity or a third party claim. This exception to the notification duty, found in Article 44 CISG, provides the possibility for the buyer to retain certain remedies despite not having given notice in accordance with Articles 39 and 43 CISG, but while still being obligated to do so. In this case, only a right to a reduction in price or claim of damages is retained and only if there is a reasonable excuse for the notice not having been given.<sup>67</sup>

Another exception that may be added is that the duty of notification, as with all obligations under the CISG, is subject to Articles 6 and 9 CISG. This means that it may be superseded by the contractual arrangements that retain the buyers' right despite his failure to give notice or

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<sup>63</sup> Article 40, Article 44 CISG (n 8).

<sup>64</sup> *Beijing Light Automobile Co v Connell* Stockholm Chamber of Commerce Arbitration Award (5 June 1998); Mullis (n 51) 164.

<sup>65</sup> Article 40 provides: 'The seller is not entitled to rely on the provisions of articles 38 and 39 if the lack of conformity relates to facts of which he knew or could not have been unaware and which he did not disclose to the buyer.'; Enderlein (n 47) 175; Camilla Baasch Andersen, 'Exceptions to the Notification Rule: Are They Uniformly Interpreted?' (2005) 9 *Vindobona Journal of International Commercial Law and Arbitration* 17.

<sup>66</sup> Andersen (n 65) 17; Mullis (n 51) 170.

<sup>67</sup> Andersen (n 65) 18; Mullis (n 51) 167.

by acknowledged trade customs (according to Article 9). In addition, the seller may waive his right to object to the fact that notice of lack of conformity was not given at all, either in a proper form or in a timely manner.<sup>68</sup> Waiver can be express or implied but it must be clear that the seller intends to waive its rights to object to the non-conforming notice. The mere fact that a seller enters into settlement negotiations does not necessarily imply that it is waiving its right to object to any defect in the notice.<sup>69</sup>

### **2.1.2.2.3 Consequences of notification for non-conformity**

The notice results in the seller's right to cure the alleged breach. This right to cure is affected by the time of actual delivery and the fundamentality of the breach. According to Articles 34 and 37 CISG, the right to cure exists only up to the latest date by which the documents must be handed over or the goods delivered under the contract. If the contractual time has passed, the seller may cure only under Article 48(2)(3) CISG and the general provisions on failure to perform contractual obligations apply.<sup>70</sup> Unlike the right to remedy under Article 48(2), Articles 34 and 37 CISG do not require the seller to request the buyer to make known his willingness to accept performance within a certain period.<sup>71</sup>

#### **2.1.2.2.3.1 Actual delivery takes place before the date set for delivery**

##### **2.1.2.2.3.1.1 Curable breaches for non-conforming goods**

If the seller has delivered the goods prior to the date set for delivery by the contract, Articles 34 and 37 expressly grant him an unfettered right to cure. The seller, up to the contractual

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<sup>68</sup> *Stainless Steel Wire Case* Supreme Court Germany (25 June 1997); Schwenger (n 51) para 33; Mullis (n 51) 168.

<sup>69</sup> *Surface Protective Film Case* Supreme Court Germany (25 November 1998); *Tiller Case* Appellate Court Oldenburg, Germany (5 December 2000); Schwenger (n 51) para 33; Mullis (n 51) 168.

<sup>70</sup> Article 45 CISG (n 8) et seq; Corinne Widmer, 'Article 34' in *Schlechtriem and Schwenger* (n 22) para 8, 564.

<sup>71</sup> Ingeborg Schwenger, 'Article 37' in *Schlechtriem and Schwenger* (n 22) 603.

time of delivery, is entitled to cure any lack of conformity in the documents,<sup>72</sup> deliver any missing part or make up any deficiency in the quantity of the goods delivered, deliver goods in replacement of any non-conforming goods delivered, or remedy any lack of conformity in the goods delivered.<sup>73</sup> In legal literature, there is agreement that this right to cure supersedes the buyer's right to avoid the contract because of a fundamental breach due to the lack of conformity breaches. Up to the date of delivery, a fundamental breach can only occur in the form of an anticipatory breach within the meaning of Article 72(1). The possibility for the seller to cure before passing the date of delivery averts the avoidance of the contract by the buyer.<sup>74</sup> However, if the date of delivery has passed, the seller will have the right to cure a non-fundamental breach. If the breach was fundamental, the buyer's right to avoid the contract prevails over the seller's right to cure.<sup>75</sup>

#### **2.1.2.2.3.1.2 Curable breaches of non-conforming documents**

The seller's duty to deliver documents relating to the goods can follow from the contract, practices between the parties or trade usages. Article 34 does not create such an obligation but presupposes it.<sup>76</sup> The contract, trade usages, and practices between the parties, generally provides for the documents that need to be provided by incorporating commercial terms. The documents must be tendered at the time and place, and in the form required by the contract. Sentence 2 of Article 34 CISG deals with cases where the documents do not conform to certain legal requirements or the terms of the contract with respect to their contents. The provision does not define the defects in documents to which it refers. The definition may be

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<sup>72</sup> Article 34 CISG (n 8).

<sup>73</sup> Article 37 CISG (n 8).

<sup>74</sup> Peter Schlechtriem, 'The Seller's Obligations Under the United Nations Convention on Contracts for the International Sale of Goods' in Nina Galston and Hans Smit (eds), *International Sales: The United Nations Convention on Contracts for the International Sale of Goods* (Matthew Bender 1984) chapter 6, 6-1 to 6-35, 6-28.

<sup>75</sup> Articles 48 and 49 CISG.

<sup>76</sup> UNCITRAL, *Digest of Case Law on the United Nations Convention on the International Sale of Goods* (United Nations 2012) article 34.



assessed according to the commercial practice. As an example, the commentaries to the Incoterms, such as the CIF clause, define a ‘clean bill of lading’ by stating which clauses may not be contained in a bill of lading and which clauses are harmless. Such ‘defects’ in documents can be cured according to Article 34 in the case of delivery before the delivery date, and according to Article 48 probably even after that date has passed.<sup>77</sup>

#### **2.1.2.2.3.1.3 Ways to cure**

A seller who has made a defective delivery before the date of delivery may cure such defects in four different ways, either singly or in combination.<sup>78</sup> For example, the seller may deliver any missing part of a machine. He may also make up any deficiency in the quantity of the goods delivered, for instance, if he originally delivered only 80 of 100 contracted bottles of a certain liquid. The seller who did not ship the complete consignment in the first shipment may supplement his delivery up to the date for delivery even without such permission.

A third method for the seller to cure non-conformities is for him to deliver goods in replacement of the non-conforming goods delivered earlier. Whether the goods are in conformity or not has to be judged in accordance with Article 35 CISG. The fourth method of curing non-conformities is to repair the defective goods or part of the goods either at the seller’s place or at the place of the buyer, whichever is more convenient, more effective and less expensive.<sup>79</sup>

#### **2.1.2.2.3.1.4 Curable breaches of legal non-conformity**

Concerning legal conformity against third party claims, Articles 41 and 42 do not use the term ‘conform’ or ‘conformity’. Nevertheless, goods with defects in title can also be

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<sup>77</sup> Schlechtriem (n 74) chapters 6, 6-1 to 6-35, 6-18.

<sup>78</sup> Honnold (n 26) 250.

<sup>79</sup> Schwenger (n 71) 604.

replaced. The only difference is that third party claims will usually not arise during the period between the early delivery and the date of delivery as envisaged in the contract. However, if the buyer himself detects the defect, he should inform the seller and the seller should be allowed to cure the defect by freeing such goods from third party rights or by replacing them.<sup>80</sup> The defects in title can be envisaged only in the sale of ascertained goods. It is unlikely that the unascertained commodities would be defective in title because such goods replace each other in performance.

#### **2.1.2.2.3.1.5 Cure and fundamental breach**

The right to cure non-conformity under Article 37 is a way to limit the injured buyer's right to avoid the contract. If the seller's attempt to remedy defects was unsuccessful, the buyer may avoid the contract only if the breach was fundamental. The buyer cannot avoid if the non-conformity is effectively 'cured' before the delivery date as the buyer cannot then be said to suffer a detriment that substantially deprives him of what he was entitled to expect under the contract.<sup>81</sup>

#### **2.1.2.2.3.1.6 Conditions to practice the right to cure**

The seller's right to cure according to Articles 34 and 37 is subject to the conditions that the curing non-conformities should never cause the buyer inconvenience or expenses that are unreasonable. If the seller's efforts to remedy the lack of conformity would cause 'unreasonable inconvenience or unreasonable expense' to the buyer, the seller would have no right to effect the repair. In addition, the buyer may avoid the contract if non-conformity was

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<sup>80</sup> Enderlein (n 65) 164.

<sup>81</sup> Lookofsky (n 2) 102.

fundamental and it becomes 'clear' that the seller will not or will be unable to cure without causing the buyer unreasonable inconvenience or expense.<sup>82</sup>

As for what constitutes reasonable, each case is different and can be decided only in the light of the individual circumstances. Unreasonable is an inconvenience exceeding in an intolerable way the normal prejudice brought about to the buyer by the replacement or repair of the goods. An example of such inconvenience is a lengthy repair of the delivered machine if the buyer has already installed it in his production line; in those circumstances, only the prompt replacement of the machine would be acceptable.<sup>83</sup> There is, however, a difference between inconvenience and expense. The buyer can claim any damages suffered despite the seller's cure. Whereas the Convention consistently uses the notion 'unreasonable' in both cases, the inconvenience rests with the buyer but the expenses, even the reasonable ones, may be claimed from the seller as damages.<sup>84</sup> If the buyer can reclaim the expenses under the damages provision in the Convention then arguably it should not be an unreasonable request to cure.<sup>85</sup> However, because of the economic risk involved, the buyer is not obliged to accept the seller's offer to pay those costs later if they are of a considerable amount. The seller then has no right to remedy the defects.<sup>86</sup>

#### **2.1.2.2.3.2 The right to cure after the date for delivery has passed**

When a seller does not deliver the goods in a timely manner or presents non-conforming goods, Article 48 permits the seller to cure the defective performance, subject to Article 49 CISG, if it does not result in unreasonable delay, unreasonable inconvenience or

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<sup>82</sup> *ibid* 102.

<sup>83</sup> Schwenger (n 71) 605.

<sup>84</sup> Enderlein (n 65) 133.

<sup>85</sup> Lachmi Singh, 'United Nations Convention on Contracts for the International Sale of Goods (1980) (CISG): An examination of the buyer's right to avoid the contract and its effect on different sectors of the (product) market' (February 2006), para 3.1 <<http://www.cisg.law.pace.edu/cisg/biblio/singh.html>> accessed 20 July 2015.

<sup>86</sup> Schwenger (n 71) 605.

unreasonable uncertainty of reimbursement by the seller of expenses advanced by the buyer.<sup>87</sup> If the seller wishes to exercise this right, he must request the buyer to make known whether he will accept performance within a time specified by the buyer. If the buyer does not answer within a reasonable time, the seller has the right to perform and the buyer has an obligation to accept performance within the time indicated in the seller's request. The buyer cannot, during this time, decide to choose another remedy that would affect performance by the seller. Nevertheless, the exercise of this right to cure is subject to the buyer's right to avoid the contract for fundamental breach. The existence of these two rights can cause friction. In some cases, where a breach was not initially fundamental, the right to avoid may arise immediately if the seller was unwilling or unable to repair. The view put forward in this thesis is that the fundamental nature of a breach must be decided not only by looking at the consequences of the breach for the buyer but also at the conduct of the seller and his willingness and capacity to remedy the breach. An example can be repeated here of a defective machine that can be repaired but the seller is unwilling to do so.<sup>88</sup> This situation is different from exclusion of the buyer's right to avoid the contract by the seller's right to cure fundamental breach by subsequent performance of contract.<sup>89</sup>

#### **2.1.2.2.3.3 Right to cure under UNIDROIT**

The UNIDROIT Principles differ from the CISG regarding the seller's right to cure. Under the Principles, there is no distinction between the sellers' right to cure before or after the date of performance; rather, there is one general right regardless of time.<sup>90</sup>

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<sup>87</sup> Singh (n 85) para 3.1.

<sup>88</sup> Alison E Williams, 'Forecasting the Potential Impact of the Vienna Sales Convention on International Sales Law in the United Kingdom' (2000-2001) Pace Review of the Convention on Contracts for the International Sale of Goods (CISG) 9.

<sup>89</sup> Markus Muller-Chen, 'Commentary on Article 45' in *Schlechtriem and Schwenzer* (n 22) 740.

<sup>90</sup> Singh (n 85) para 3.1.

### **2.1.2.3 *Nachfrist* notice**

The *Nachfrist* remedy complements the right to require performance under Article 46 but it has a particular association with the right to avoid the contract under Articles 49(1)(b) and 64(1)(b) CISG. Where the party has failed to comply with any of his obligations, the aggrieved party has the right to fix an additional period of time (*Nachfrist*) within which the defaulting party must perform his obligations. The remedy of avoidance is available after fruitless expiration of the *Nachfrist* for the buyer and for the seller: (1) the buyer can declare the contract avoided if the seller fails to deliver by the expiration of the additional period fixed in accordance with Article 47 CISG; and (2) the seller may declare the contract avoided if the buyer does not pay the price or take delivery of the goods within the additional period set in accordance with Article 63 CISG.

#### **2.1.2.3.1 Form**

There is no special requirement of the form the buyer must employ in fixing the additional period. It is irrelevant whether the buyer's extension of time was communicated in writing or orally.<sup>91</sup> Several decisions appear to have inferred the existence of an additional period simply from the inaction of the aggrieved party when faced with a longer delay in performance whether such a delay was to deliver the goods or payment of the price. It has been held that the buyer's tolerance of the late delivery of the three initial instalments was equivalent to the granting of an 'additional period of time' to the seller, in accordance with Article 47 CISG.<sup>92</sup> In *Foamed board machinery*<sup>93</sup> the arbitral tribunal regarded the period between the buyer's default and the declaration of avoidance by the seller as an 'additional period' fixed by the seller under Articles 63(1) CISG and 64(1)(b) CISG. However, it does

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<sup>91</sup> UNCITRAL (n 76) article 47.

<sup>92</sup> *Rolled Steel Case* Appellate Court Barcelona, Spain (3 November 1997).

<sup>93</sup> *Foamed Board Machinery Case* ICC Arb Case No 7585 (1992).

not seem accurate to conclude *Nachfrist* due to the mere inaction of the aggrieved party because the *Nachfrist* notice requires specifying a certain obligation to perform within a stated period. In the described cases above, the longer delay was a fundamental breach by itself.

#### **2.1.2.3.2 Content**

The content of a *Nachfrist* notice must satisfy certain requirements. A clear expression that the party is granting a final deadline for a certain performance is necessary. When a buyer or seller fixes an additional period, he must stipulate the demanded performance, whether it was to deliver, to take delivery or to pay the price. A precatory phrase, such as ‘I hope the price will be paid by June 1<sup>st</sup>’ is not sufficient. The seller must clearly indicate that the buyer has to perform within a fixed or determinable additional period. Similarly, in case of delay by the seller, the buyer must make clear that the seller has to deliver within the additional fixed time in order to properly invoke Article 49(1)(b) CISG and be entitled to avoid the contract without having to show that the seller’s delay was a fundamental breach. The buyer may state to the seller: ‘You have until May 1<sup>st</sup> to deliver the goods’. On the other hand, it is not necessary for the party demanding performance to threaten to avoid the contract in case of fruitless expiration of the *Nachfrist*.<sup>94</sup> However, at the same time as setting the *Nachfrist* the party may declare the contract avoided in case the other party does not keep to it.<sup>95</sup>

In addition, the time given for performance must be of a reasonable length to satisfy the requirements of Article 47(1). What is reasonable depends largely on the circumstances. In a case involving a Danish-German car sale,<sup>96</sup> an additional period of three to four weeks for

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<sup>94</sup> *Auto Case* Appellate Court München, Germany (19 October 2006).

<sup>95</sup> Fritz Enderlein and Dietrich Maskow, *International Sales Law, United Nations Convention on Contracts for the International Sale of Goods: Convention on the Limitation Period in the International Sale of Goods* (Oceana 1992) 192.

<sup>96</sup> *Automobile Case* Appellate Court Naumburg, Germany (27 April 1999).

delivery was found to be reasonable. All relevant circumstances of the case have to be taken into account, including the conduct of the parties, negotiations and practices between them, and usages as per Article 8(3) CISG.<sup>97</sup> The party fixing an additional time is bound by the time fixed even if the period fixed is longer than a reasonable time.<sup>98</sup> Fixing an unreasonably short period for performance only triggers a reasonable period that a party must wait for before dispatching its notice of avoidance.<sup>99</sup> In *Used printing press*<sup>100</sup> an additional period of two weeks for the delivery of three printing machines from Germany to Egypt was deemed to be too short, but the Court also found that the period of seven weeks between announcement and actual declaration of avoidance was reasonable. In *Spanish paprika*<sup>101</sup> the Court determined that the period established by a German buyer for delivery of conforming goods by a Spanish seller of paprika was reasonable on the basis that the buyer only declared the contract avoided two weeks after the expiration of the original additional period to perform.<sup>102</sup> However, a party who has fixed a too short period and seeks to declare the contract avoided after the unreasonably short length of time may only do so if a fundamental breach has occurred.<sup>103</sup> There are two possibilities for declaring avoidance after the expiry of an unreasonably short *Nachfrist*. According to one view, such a period is devoid of effect; therefore, the declaring of avoidance will constitute a fundamental breach. According to the

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<sup>97</sup> *Cathode Ray Tube Case* District Court Strasbourg, France (22 December 2006). The judgment referred to the role of usages and practices between the parties. *Arens Sondermaschinen GmbH v Smit Draad/Draad Nijmegen BV* Netherlands (7 October 2008) Gerechtshof [Appellate Court] Arnhem (8-12 weeks offered by buyer regarded as reasonable); *Bacon Case* District Court Bielefeld, Germany (18 January 1991) (A reasonable period with regard to taking delivery of the goods will generally be longer than that applying to payment of the price. A period of 29 days for taking delivery of 200 tons of bacon was deemed reasonable); see also UNCITRAL (n 76) article 63.

<sup>98</sup> John C Duncan, 'Nachfrist Was Ist? Thinking Globally and Acting Locally: Considering Time Extension Principles of the UN Convention on Contracts for the International sale of goods in Revising the Uniform Commercial Code' (2000) Brigham Young University Law Review 1363, 1385.

<sup>99</sup> *Automobile Case* (n 96).

<sup>100</sup> *Used Printing Press Case* Appellate Court Celle, Germany (24 May 1995).

<sup>101</sup> *Spanish Paprika Case* District Court Ellwangen, Germany (21 August 1995).

<sup>102</sup> See also UNCITRAL (n 76) article 47.

<sup>103</sup> Duncan (n 98) 1385.

other view, an additional period of reasonable length replaces the rejected period owing to its shortness. At least one court decision has expressly adopted this second approach.<sup>104</sup>

### **2.1.2.3.3 The consequences of setting *Nachfrist***

The party may not resort to any other remedy during the stated period<sup>105</sup> with the exception of the right to claim damages for the delay.<sup>106</sup> There are three possibilities after expiry of *Nachfrist*. The defaulting party may refuse to perform, may fail to perform or may perform defectively.

If the defaulting party refuses to perform, the aggrieved party need not wait until the expiration of the *Nachfrist*. In this situation, the aggrieved party gains a right to avoid the contract or he may bring a claim for specific performance. The second effect is that the fixing of an additional period facilitates the contract avoidance in cases of non-delivery by the seller and non-payment of the price or failure to take delivery of the goods by the buyer. Upon expiration of *Nachfrist*, the aggrieved party is entitled to resort to any remedy including avoidance of the contract. If the defaulting party has performed during the additional period, the aggrieved party must accept performance unless the performance resulted in a fundamental breach.

## **2.2 Conclusion**

The buyer may lose his right to avoid the contract if he failed to specify certain information in his notice declaring avoidance. There is no special formality for giving notice under the Convention. However, for practical considerations the notice of avoidance must clarify the buyer's choice of avoidance. Depending on the nature of the breached obligation, the notice

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<sup>104</sup> *Antique Jaguar Sports Car Case* Appellate Court Karlsruhe, Germany (14 February 2008) (time limit of two weeks in place of seven days).

<sup>105</sup> Article 63(2) first sentence.

<sup>106</sup> Article 63(2) second sentence; UNCITRAL (n 76) article 47; Duncan (n 98) 1387.



must include certain elements to be informative enough about the avoidance. In the notice of non-conformity, for example, the notice must specify the nature of the lack of conformity. The notice of third party claim must specify the nature of the right or claim of the third party. If the clarity of the notice is disputed, the meaning of the notice should be interpreted in conformity with what a reasonable person would have understood in the same circumstances.

### **Chapter Three: Reasonable time under Articles 49(2) and 64(2) CISG**

The CISG subjects the aggrieved party's right to avoid the contract to a reasonable time but only in a limited set of cases.<sup>1</sup> Thus, the avoiding party may lose his right to declare the contract avoided unless he does so within a reasonable time.<sup>2</sup> The idea of reasonableness is very broad and its application has revealed a level of inconsistency by some courts and tribunals.<sup>3</sup> This term needs guidelines for its interpretation otherwise it might be too imprecise to ensure uniformity and legal certainty. The purpose of the following discussion is to explain where the time limitations for avoidance apply under the CISG, and how the legal literature and international courts' practices have understood the reasonable time to declare avoidance.

This chapter will be divided into three sections: the first one considers the concept of reasonableness as a requirement to avoid the contract in some international legal systems; the second considers the application of the concept of reasonable time as a requirement for avoidance under the CISG; and the third explains the concept of reasonable time in the light of the underlying policies of the Convention.

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<sup>1</sup> Articles 49(2) and 64(2) United Nations Convention on Contracts for International Sale of Goods (11 April 1980, entered into force 1 January 1988) 1489 UNTS 3 (CISG/Vienna Convention/The Convention).

<sup>2</sup> Although reasonableness is not defined in the CISG, it is considered a general principle upon which the Convention is based, and so applies to all issues governed by but not settled in the CISG by virtue of Article 7(2) of the Convention. Albert H Kritzer, 'Overview Comments on Reasonableness' <<http://www.cisg.law.pace.edu/cisg/text/reason.html#overv>> accessed 20 January 2015; Ulrich Magnus, 'Remarks on Good Faith: The United Nations Convention On Contracts For The International Sale Of Goods And The International Institute For The Unification Of Private Law, Principles Of International Commercial Contracts' (June 1998) 10 Pace International Law Review 89.

<sup>3</sup> Ari Korpinen, 'On Legal Uncertainty Regarding Timely Notification of Avoidance of the Sales Contract' (2005) NJCL 1, 5; Camilla Baasch Andersen, 'Reasonable Time in Article 39(1) of the CISG: Is Article 39(1) Truly a Uniform Provision?' <<http://www.cisg.law.pace.edu/cisg/biblio/andersen.html>> accessed 12 July 2015.

### 3.1 Time limits to avoid the contract in different legal instruments

These legal international trade instruments include ULIS, the precursor to the CISG, the UNIDROIT Principles (PICC), the PECL and the Common European Sales Law (CESL). The latter two are the direct opposite of the CISG approach.

#### 3.1.1 ULIS

The ULIS<sup>4</sup> provided two types of avoidance. The first one was called *ipso facto* avoidance and occurred in five specific cases,<sup>5</sup> either automatically upon the breach unless the aggrieved party required performance of the contract promptly<sup>6</sup> or within a reasonable time.<sup>7</sup>

In cases other than *ipso facto* avoidance, the party entitled to declare the contract avoided was obliged to, as a rule, inform the other party promptly, within as short a period as possible,<sup>8</sup> that he exercised his right of avoidance. Otherwise, the contract would survive in spite of the occurrence of the fundamental breach.<sup>9</sup> In addition, the ULIS granted the buyer the right to avoid the contract within a reasonable time from the moment he became aware or ought to

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<sup>4</sup> Convention Relating to a Uniform Law for the International Sale of Goods (1 July 1964) 834 UNTS 169 (ULIS).

<sup>5</sup> Michael Will, 'Article 49' in CM Bianca and MJ Bonell (eds), *Commentary on the International Sales Law* (Giuffrè 1987) 360, para 1.2.1.1.

<sup>6</sup> For example, in Articles 67 if the buyer fails to determine the form, measurement or other features of the goods (sale by specification), the seller may declare the contract avoided provided that he does so promptly.

<sup>7</sup> For example, where the failure to deliver the goods at the date fixed amounts to a fundamental breach of the contract, the buyer may either require performance by the seller or declare the contract avoided within a reasonable time, otherwise the contract shall be *ipso facto* avoided. (Article 26 ULIS (n 4)); See Hamza Haddad, *Remedies of the unpaid seller in international sale of goods under ULIS and 1980 UN Convention* (1<sup>st</sup> edn, Amman 1985) para 47, 48, 50-51.

<sup>8</sup> Article 11: 'Where under the present Law an act is required to be performed 'promptly', it shall be performed within as short a period as possible, in the circumstances, from the moment when the act could reasonably be performed.'

<sup>9</sup> Article 55: '1. If the seller fails to perform any obligation other than those referred to in Articles 20 to 53, the buyer may: (a) where such failure amounts to a fundamental breach of the contract, declare the contract avoided, provided that he does so promptly, and claim damages in accordance with Articles 84 to 87, or (b) In any other case, claim damages in accordance with Article 82. 2. The buyer may also require performance by the seller of his obligation, unless the contract is avoided.'

have become aware of the right or claim of the third person in respect of the goods.<sup>10</sup> However, there was no definition of reasonable time in the ULIS.

### **3.1.2 UNIDROIT Principles**

The requirements for avoidance for non-delivery or late delivery under the CISG and the PICC do not differ in substance.<sup>11</sup> Under the PICC, avoidance of contract (termination) is restricted to a reasonable time in cases where the performance has been offered late or otherwise does not conform to the contract.<sup>12</sup> The aggrieved party will lose his right to terminate the contract if he did not notify the breaching party of his avoidance within a reasonable time after he has or ought to have become aware of the offer or of the non-conforming performance.<sup>13</sup> The PICC, however, does not define the reasonable time.

### **3.1.3 PECL**

The PECL also restricts the power to terminate the contract to a reasonable time limitation but uses a different approach than that of the PICC. The PECL requires notice in a reasonable time for all terminations. The aggrieved party might terminate the contract after he has become aware of non-performance or after he ought to have been aware.<sup>14</sup> This is a general limitation on the power to terminate the contract and applies to all cases of non-performance.

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<sup>10</sup> Article 52(4): 'The buyer shall lose his right to declare the contract avoided if he fails to act in accordance with paragraph 1 of this Article within a reasonable time from the moment when he became aware or ought to have become aware of the right or claim of the third person in respect of the goods.'

<sup>11</sup> Robert Koch, 'Commentary on Whether the UNIDROIT Principles of International Commercial Contracts May Be Used to Interpret or Supplement Articles 47 and 49 of the CISG' (December 2004) section III <<http://www.cisg.law.pace.edu/cisg/biblio/koch2.html>> accessed 8 April 2015.

<sup>12</sup> Article 7.3.2(2) UNIDROIT, *Principles of International Commercial Contracts* (3<sup>rd</sup> edn, 2010) (PICC).

<sup>13</sup> Article 7.3.2(2) PICC (n 12).

<sup>14</sup> Article 9:303(2) Commission on European Contract Law, *Principles of European Contract Law* (Parts I and II revised 1998, Part III 2002) (PECL).

Neither the PICC nor CISG contain such general limitations; instead, the time restrictions in the PICC and CISG apply to a limited set of cases of breach.<sup>15</sup>

### 3.1.4 CESL

The CESL acknowledges the passing of reasonable time as a reason to lose the right to terminate the contract by the buyer or the seller. The buyer must give notice within a reasonable time from when the right arose or the buyer became, or could be expected to have become, aware of the non-performance, whichever is later.<sup>16</sup> On the other hand, if performance has been tendered late or a tendered performance otherwise does not conform to the contract, the seller loses the right to terminate under this Section unless notice of termination is given within a reasonable time from when the seller has become, or could be expected to have become, aware of the tender or the non-conformity.<sup>17</sup>

### 3.1.5 CISG

In general, the Convention places no time limitations on the aggrieved party's power to declare the contract avoided.<sup>18</sup> In cases of fundamental breach for non-performance and anticipatory fundamental breach, as well as in cases of the breaching party's failure to comply within an additional fixed time,<sup>19</sup> the innocent buyer, and equally the innocent seller, can exercise his right of avoidance at any time. He may declare the contract avoided

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<sup>15</sup> Mercédeh Azeredo da Silveira, 'Termination of Contract under the Principles of European Contract Law: A Comparative Study' (2006) section III <<http://www.cisg.law.pace.edu/cisg/biblio/silveira.html>> accessed 9 August 2015; Jonathan Yovel, 'Seller's Right to Avoid the Contract in International Transactions: Comparative analysis of the respective provisions in the CISG (Article 64) and in the PECL' (2005) <<http://www.cisg.law.pace.edu/cisg/biblio/yovel64.html>> accessed 20 January 2015; Jonathan Yovel, 'Buyer's right to avoid the contract: Comparison between provisions of the CISG (Article 49) and the counterpart provisions of the PECL (Articles 9:301, 9:303 and 8:106)' (2005) <<http://www.cisg.law.pace.edu/cisg/biblio/yovel49.html>> accessed 20 January 2015.

<sup>16</sup> Article 121(1) Commission, 'Proposal for a Regulation of the European Parliament and of the Council on a Common European Sales Law (CESL)' COM (2011) 635 final.

<sup>17</sup> *ibid* article 142(1).

<sup>18</sup> Only the general rule of limitation applies, see: Ulrich Magnus, 'The Remedy of Avoidance of Contract Under CISG: General Remarks and Special Cases' [2005-06] 25 *Journal of Law and Commerce* 423, 429.

<sup>19</sup> This is according to the rule of *Nachfrist* by the buyer or seller in Article 47(1) and Article 48(2) CISG respectively.

immediately or wait in the hope that the breaching party meets his obligations.<sup>20</sup> The aggrieved party is allowed to set a curative period according to Article 47(1) or Article 63(1) CISG.<sup>21</sup>

However, the Convention lays down two important time restrictions where the avoidance has to be declared within a reasonable time. If the avoiding party fails to comply with these time restrictions, his right of avoidance may be lost.<sup>22</sup> These time restrictions are provided only in two exceptional situations:<sup>23</sup> when the seller has delivered the goods;<sup>24</sup> and when the buyer has paid the price in full.<sup>25</sup>

The following sections examine these limitations in the CISG and attempt to provide an explanation of the concept of reasonable time as a determining factor in the remedy of avoidance.

### **3.2 The application of reasonable time to avoid the contract**

#### **3.2.1 Avoidance of the contract by the buyer**

In cases where the seller has delivered the goods before or after the date of delivery, the buyer, subject to establishing a fundamental breach on the seller's side, can exercise the right

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<sup>20</sup> A buyer who fails to react for a prolonged period to a seller's refusal to deliver may lose his right to damages under the good faith principle even before it is time-barred but retains his right to avoid the contract. See Markus Müller-Chen, 'Article 49' in Ingeborg Schwenzer (ed), *Schlechtriem and Schwenzer, Commentary on the UN Convention on the International Sale of Goods (CISG)* (3rd edn, Oxford University Press 2010) 759; Tobias Plate, 'The Buyer's Remedy of Avoidance under the CISG: Acceptable from a Common Law Perspective?' [2002] 6 *Vindobona Journal of International Commercial Law and Arbitration* 57, 71.

<sup>21</sup> John Honnold, *Uniform Law for International Sales under the 1980 United Nations Convention* (3rd edn, Kluwer Law International 1999) para 307 and para 356; Yovel, 'Seller's Right' (n 15); Magnus (n 18) 434.

<sup>22</sup> Yan Li, 'Remedies for Breach of Contract in the International: A Comparative Study between the CISG, Chinese Law and English Law with reference to Chinese Cases' (PhD thesis, University of Southampton 2010) 60.

<sup>23</sup> One judgment by the Supreme Court of Austria states that: 'The avoidance of a contract is made by unilateral declaration of the party faithful to the contract to the other party (citation omitted); it does not require a specific form and generally, with the exception of the cases of Article 49(2) CISG [and Article 64(2) on 'reasonable time' requirement], is not subject to a specific deadline (citation omitted.)' *Propane Case* Supreme Court Austria (6 February 1996).

<sup>24</sup> Peter Huber, 'Article 49' in Stefan Kröll, Loukas A Mistelis and Maria del Pilar Perales Viscacillas (eds), *UN Convention on Contracts for the International Sale of Goods (CISG)* (CH Beck-Hart-Nomos 2011) 722, 741ff.

<sup>25</sup> Gary F Bell, in Kröll, Mistelis and del Pilar Perales Viscacillas (n 24) 870.

of avoidance only during a reasonable time thereafter.<sup>26</sup> This time limit applies only if the seller has delivered the goods. Article 49(2) provides a ‘complicated’<sup>27</sup> regime to determine the starting point for reasonable time, depending on the type of breach that has led to the right of avoidance, whether it was late delivery or some other breach.<sup>28</sup>

### **3.2.1.1 Late delivery<sup>29</sup>**

If the avoidance is to be based on late delivery, reasonable time starts when the buyer ‘has become aware that delivery has been made’.<sup>30</sup> The language of Article 49(2)(a) suggests that the ‘reasonable time’ for avoidance starts running only upon a buyer’s actual subjective awareness of delivery.<sup>31</sup> This test of ‘actual awareness’ has been criticised because it refers to the buyer’s actual knowledge of the fact of delivery and this requires a kind of subjective element that is not easy to detect.<sup>32</sup> However, some studies have submitted that, due to the practical difficulties to prove this knowledge, the court would have to consider that the period starts to run after the buyer could have been aware of the delivery of the goods.<sup>33</sup> Thus, a reasonable period begins as soon as the buyer receives the notice of dispatch or when the transport documents reach him, but certainly when he receives the goods themselves;<sup>34</sup> the

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<sup>26</sup> Magnus (n 18) 428.

<sup>27</sup> It has, together with Article 64, been called ‘the most complicated rule of the entire convention’ due to its complex structure and practical difficulties in application; Li (n 22) 71.

<sup>28</sup> Huber (n 24) 741.

<sup>29</sup> This is applicable to both cases of conforming delivery where the delay constitutes a fundamental breach, or where delivery occurs after expiration of an additional period set by the buyer according to Article 47. See Müller-Chen (n 20) 741.

<sup>30</sup> Article 49(2)(a) CISG (n 1).

<sup>31</sup> Jamming Shen, ‘Declaring the Contract Avoided: The U.N. Sales Convention in the Chinese Context’ (Winter 1997) 10(1) *New York International Law Review* 7, note 107.

<sup>32</sup> Khaled Abd El Hamid, ‘The Avoidance of the Contract for International Sale of Goods according to the Vienna Convention 1980’ (PhD Thesis, Cairo University, 2001) para 305.

<sup>33</sup> Abd El Hamid (n 32) para 305.1.

<sup>34</sup> Müller-Chen (n 20) 760; Huber (n 24) 742.

seller bears the burden of proof in that respect.<sup>35</sup> In the absence of clear indicators, the question of when the period begins to run is invariably left to judicial discretion.<sup>36</sup>

### **3.2.1.2 Other types of breach**

Article 49(2)(b) regulates the time limits if the declaration of avoidance is to be based on any other fundamental breach that is not late delivery.<sup>37</sup> For example, delivery of non-conforming goods, failure to hand over conforming documents or failure to transfer property to the buyer free from third party rights or claims.<sup>38</sup> The CISG provides three different starting points for the limitation period: know or ought to have known; expiration of the additional *Nachfrist* period; and expiration of the additional period fixed by the delayed seller.

#### **3.2.1.2.1 Know or ought to have known**

Generally, the reasonable period begins to run after the buyer ‘knows or ought to have known of the breach’.<sup>39</sup> The buyer knows of the breach if he has positive knowledge of the facts of the breach and its extent and importance.<sup>40</sup> The buyer ought to have known of the breach if he was negligent or carelessly ignorant of specific indications pointing to a fundamental breach of contract,<sup>41</sup> for instance, if the buyer did not examine the goods for defects and other kinds of non-conformity as required by Article 38 CISG.<sup>42</sup> However, this does not imply that the buyer is under an obligation to reassure himself that there is no breach of contract.<sup>43</sup>

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<sup>35</sup> Müller-Chen (n 20) 760; Huber (n 24) 742.

<sup>36</sup> Yovel, ‘Seller’s Right’ (n 15) 30.

<sup>37</sup> Plate (n 20) 71.

<sup>38</sup> Müller-Chen (n 20) 764; Huber (n 24) 742.

<sup>39</sup> Article 49(2)(b)(i) CISG (n 1).

<sup>40</sup> Müller-Chen (n 20) 763; Huber (n 24) 742.

<sup>41</sup> Müller-Chen (n 20) 764; Huber (n 24) 742.

<sup>42</sup> Honnold (n 21) para 308.

<sup>43</sup> Plate (n 20) para 3.2.



If the reasonable time has already passed according to Article 49(2)(b)(i), the avoidance might still be possible by setting a grace period.<sup>44</sup>

### **3.2.1.2.2 Expiration of the additional *Nachfrist* period**

This situation presupposes that the buyer, who is entitled to require performance under Article 46 CISG, has fixed an additional period of time of reasonable length according to Article 47 for the seller to deliver substitute goods or cure the defect in delivered goods. The reasonable period to avoid the contract will begin to run after the expiration of the *Nachfrist* with the seller's failure to perform or after the seller's declaration that he will not perform within this period.<sup>45</sup> If the buyer loses his right to avoid the contract pursuant to Article 49(2)(b)(ii), he may fix a new additional period for performance and avoid the contract after its expiration to no avail.<sup>46</sup>

### **3.2.1.2.3 Expiration of the additional period fixed by delayed seller**

In cases of delayed performance or delivery of non-conforming goods, the seller may request the buyer to make known whether he will accept the performance or cure which will take place within an additional, reasonable period.<sup>47</sup> If the seller fails to remedy the defect within that period, the time limit to declare avoidance will start to run after the expiration of the additional period fixed by the seller or after the buyer has declared that he will not accept performance.<sup>48</sup> It has been noted that both paragraphs (ii) and (iii) of Article 49(2)(b) seem 'redundant and ungracefully inflate'<sup>49</sup> Article 49 as they are mere applications of Articles 47(2) and 48(2).

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<sup>44</sup> *ibid.*

<sup>45</sup> Huber (n 24) 765.

<sup>46</sup> Plate (n 20) para 3.2.

<sup>47</sup> Huber (n 24) 766.

<sup>48</sup> Art 49(2)(b)iii CISG (n 1).

<sup>49</sup> Honnold (n 21) para 308; Will (n 5) para 2.2.1.2, 365.

### 3.2.2 Avoidance of the contract by the seller

The avoiding seller, if the buyer has fully paid the price, must react within a reasonable time in order not to lose his right to declare the contract avoided.<sup>50</sup> As long as the price has not been fully paid, no time limits apply to the seller's right of avoidance.<sup>51</sup> In case of payment by instalments, all instalments must have been paid.<sup>52</sup> Payment in the wrong place or in the wrong currency does not render avoidance time limits applicable.<sup>53</sup>

From a practical viewpoint, it has been noted that the seller is unlikely to seek avoidance of contract for which he has been rightfully paid.<sup>54</sup> However, there are many situations where the seller may have adequate ground to declare avoidance because of the buyer's non-performance. For example, when the buyer fails to take possession of the goods or does not generate required certificates, the seller might find himself in breach of contract with other parties (carriers, port authorities, etc.) or in legal problems. In addition, a buyer's non-performance may affect the seller's long-term investments or promoting programs.<sup>55</sup>

Article 64 CISG sets the start of the reasonable avoidance period by using an almost identical approach to the one that applies to a buyer's avoidance where the seller has already delivered the goods.<sup>56</sup> Accordingly, one has to distinguish between two situations to decide when the limitation period should start to run. The first situation is the delayed performance and the second will encompass any other breach that is not late performance.

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<sup>50</sup> Bell (n 25) 870.

<sup>51</sup> Florian Mohs 'Article 64' in *Schlechtriem and Schwenzler* (n 20) 903.

<sup>52</sup> *ibid* 903.

<sup>53</sup> *ibid* 903.

<sup>54</sup> Honnold (n 21) para 356.

<sup>55</sup> Yovel 'Seller's Right' (n 15) section 9.

<sup>56</sup> Magnus (n 18) 428.

### **3.2.2.1 Late performance**

Where the buyer performs any of his contractual obligations late and this delay constitutes a fundamental breach, the seller loses his right to terminate the contract as soon as he becomes aware that the performance has been rendered.<sup>57</sup> The late performed obligation might be any of the buyer's duties that are imposed by the contract or the Convention, such as the obligation to pay the purchase price or the obligation to take the delivery.<sup>58</sup>

### **3.2.2.2 Other types of breach**

In respect of any breach other than late performance by the buyer, the start of the reasonable avoidance period will be decided upon by using one of two factors: the seller's knowledge of the breach or the expiration of the grace period.

#### **3.2.2.2.1 The seller's knowledge of the breach**

The basic rule is that the reasonable avoidance period starts to run after the seller knows or ought to know of the breach.<sup>59</sup> This rule is applicable to performance of any of the buyer's outstanding obligations other than payment of the purchase price.<sup>60</sup> If the payment is still outstanding Article 46(1)(a) or (b) applies and the seller's right to terminate the contract is not subject to any time limits at all.<sup>61</sup>

#### **3.2.2.2.2 Expiration of any additional period**

Expiration occurs after any additional period fixed by the seller in accordance with paragraph (1) of Article 63 ends or after the buyer declares that he will not perform his obligations

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<sup>57</sup> Art 64(2)a CISG (n 1).

<sup>58</sup> Bell (n 25) 871.

<sup>59</sup> Art 64(2)(b)i CISG (n 1).

<sup>60</sup> Yovel 'Seller's Right' (n 15) section 9.

<sup>61</sup> Mohs (n 51) 905.

within such an additional period.<sup>62</sup> It is necessary to consider whether the seller loses his right to declare the contract avoided if the buyer performs his obligation late after the expiry of the grace period, assuming that the payment has been made and the seller is aware of the late performance.<sup>63</sup>

One view is that Article 64(2)(b) should apply rather than Article 64(2)(a). That is, even though the seller is aware that the obligation has been performed, he could still avoid the contract within a reasonable time after expiration of the additional period or within a reasonable time after the buyer has declared that he will not perform within that additional period of time.<sup>64</sup> Another view is that Article 64(2)(b) does not apply. There is only one type of 'late performance' as the Convention makes no distinction between a performance which is late according to the contract and a performance which is very late – a performance after expiration of the grace period is a late performance and should be governed by Article 64(2)(a), not (b).<sup>65</sup> In addition, the buyer should be allowed to perform until the contract has been declared avoided. Since the seller is still entitled to ask for performance after the end of the grace period, it would be odd to say that the seller may declare the contract avoided even after the buyer has performed his obligation.<sup>66</sup>

The latter view seems to be more supported by the Convention's goals as these consider avoidance as a remedy of last resort and aim to preserve the contract in international transactions. Accordingly, Article 64(2)(b)(ii) will only apply to the obligations that have not been performed after the expiration of the grace period.<sup>67</sup>

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<sup>62</sup> Art 46(2)(b)ii CISG (n 1)

<sup>63</sup> Bell (n 25) 871.

<sup>64</sup> Commentary on the 1978 draft cited in Bell (n 25) 871.

<sup>65</sup> Bell (n 25) 871.

<sup>66</sup> *ibid* 872.

<sup>67</sup> *ibid* 872.

To sum up, the reasonable time limit only restricts the aggrieved party's right to declare the contract avoided in two cases: where the seller has delivered the goods and where the buyer has paid the full price. In these two cases, the aggrieved party loses his right of avoidance if he did not react within a reasonable time.

### **3.3 Interpretation of reasonable time and its underlying policies**

While the CISG mentions the concept of reasonableness in 37 of its Articles,<sup>68</sup> it sheds no light on the definition of this idea. One approach to the interpretation of reasonable time would be to consider reasonableness in its definition and execution of contractual obligations as an articulation of the principle of good faith. In the context of avoidance under the CISG, this approach would undermine the distinction between cases where the aggrieved party's power to avoid the contract is unrestricted to a time limitation and cases of restricted avoidance to a reasonable time. Under the general obligation of good faith, surely any declaration of avoidance must be made in a reasonable time so as not to create undue hardship for the breaching party. Thus, the limitation of the power of avoidance to a 'reasonable time' under the CISG, when the goods have been delivered or the price has been paid, would then become, in fact, tautological.<sup>69</sup>

Another approach that provides some assistance to the interpretation of this term can be found in Article 1:302 of the PECL: 'reasonableness is what reasonable persons, acting in good faith and in the same situation as the parties, would consider reasonable'. The PECL also stated the factors that should be taken into account when assessing what constitutes a reasonable time; for example, the nature and purpose of the contract; the circumstances of the case, and the usages and practices of the trades or professions involved; the payment

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<sup>68</sup> Articles: 8(2), 8(3), 16(2)(b), 18(2), 25, 33(c), 34, 35(2)(b), 37, 38(3), 39(1), 43(1), 44, 46(3), 47(1), 48(1), 48(2), 49(2)(a), 49(2)(b), 60(a), 63(1), 64(2)(b), 65(2), 72(2), 73(2), 75, 76(2), 77, 79(1), 79(4), 85, 86(1), 86(2), 87, 88(1), 88(2), 88(3) CISG (n 1).

<sup>69</sup> Yovel, 'Buyer's right' (n 15) para 7.5.

arrangements; third party claims; and whether legal advice or expert opinions were actually necessary in order to determine concrete rights.<sup>70</sup>

However, while this definition gives practitioners a slightly better idea of the standards to gauge reasonableness, it is circular and insufficient for a proper assessment of the timely or untimely declaration of avoidance.<sup>71</sup> It would be more helpful to add particular recognition to the policies underlying the requirement of reasonable time.

The reasonable time depends not only on the circumstances of the particular case but also on the purpose of the particular provision of the Convention that requires an action to be completed within such a time. The contextual criterion, which can be drawn from the official commentaries and case law, can help to provide a better understanding of the underlying policies of the reasonable time requirements.

The official UNIDROIT Commentary on the PICC provides helpful reasoning for the need for speed to be a requirement of effective notification in provision 7.3.2 (equivalent 49). The right of a party to terminate the contract is exercised by notice to the other party. The notice requirement will permit the non-performing party to avoid any loss due to uncertainty as to whether the aggrieved party will accept the performance. At the same time it prevents the aggrieved party from speculating on a rise or fall in the value of the performance to the detriment of the non-performing party.<sup>72</sup>

This interpretation of reasonable time has been acknowledged in the CISG's case law as well. For example, a German court ruled that a lengthy pending status is irreconcilable with the

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<sup>70</sup> For further discussion regarding the correlation between the PECL's definition of reasonableness and the meaning of this term from CISG drafters, see Commentary on Reasonableness <<http://www.cisg.law.pace.edu/cisg/text/reason.html#overv>> accessed 20 April 2015; Yovel, Buyer's right (n 15) para 7.3.

<sup>71</sup> Yovel, 'Buyer's right' (n 15) para 7.4.

<sup>72</sup> CISG, 'Use of the UNIDROIT Principles to help interpret CISG Article 26' <<http://cisgw3.law.pace.edu/cisg/principles/uni26.html>> accessed 13 May 2015.

protection of the seller's right to learn, as quickly as possible, whether the buyer is going to use his right and declare the contract avoided.<sup>73</sup> Similarly, eight weeks were held to be unreasonable for the remedy of avoidance in a case involving the sale of acrylic blankets, even after taking into account the time required for consideration, to obtain legal advice and for negotiations between the parties. In the court's opinion: 'The period of time considered reasonable must be determined in the light of the seller's interest in certainty and whether the seller has to arrange for alternative use of the goods'.<sup>74</sup> Another case held that a period of more than four months does not constitute a reasonable period within the meaning of Article 49(2)(b) CISG because '[t]his provision is intended to prevent a long state of uncertainty for the [seller] after the delivery and to inform the [seller] of how he himself may proceed with the goods'.<sup>75</sup>

Courts and commentators have also recognized certain facts or circumstances in determining whether the notice of avoidance was given in a timely or untimely manner. These circumstances or the facts that have been taken into account in assessing reasonableness in time might be grouped into two categories. The first includes the factors that shorten the reasonable period and the second include the factors that may result in a lengthy period.

### **3.3.1 Circumstances that result in a shortened reasonable time**

In these circumstances, a suggestion might be made that the length of the period has to be measured in days rather than in weeks. Examples of cases that fall under this group are given below.

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<sup>73</sup> *Furniture Case* Appellate Court Oldenburg, Germany (1 February 1995).

<sup>74</sup> *Acrylic Blankets Case* Appellate Court Koblenz, Germany (31 January 1997).

<sup>75</sup> *Coke Case* Appellate Court München, Germany (2 March 1994); for further requirements of declaration of avoidance in CISG, IPCC and PECL see Chengwei Liu, 'Declaration of Avoidance: Perspectives from the CISG, UNIDROIT Principles and PECL and case law' (2<sup>nd</sup> edn, June 2005) para 5 <<http://www.cisg.law.pace.edu/cisg/biblio/liu10.html>> accessed 3 May 2015.

### **3.3.1.1 Late performance by the buyer or by the seller**

#### **3.3.1.1.1 Late delivery**

If the avoidance is grounded on late delivery, the length of the reasonable period is generally regarded as being very short and should be measured in days rather than weeks.<sup>76</sup> The reason for this is that, typically, if the late delivery amounts to a fundamental breach, the buyer does not need much time to make up his mind whether he wants to use the late delivered goods or reject them.<sup>77</sup> This rule aims to protect a seller's interest of reliance on concluded contracts.<sup>78</sup> The seller who has delivered conforming goods but is still in breach due to late delivery has a considerable interest in being informed, as quickly as possible, of the fact that the buyer intends to invoke the remedy of avoidance because then he has the problem of disposing of the goods elsewhere probably by finding another buyer.<sup>79</sup>

#### **3.3.1.1.2 Late payment**

The CISG imposes restrictions on the seller's power to avoid the contract when the price has been paid. This is in order to protect the reliance interest of the breaching buyer during his attempt to cure and to motivate both the aggrieved seller not to postpone a declaration of avoidance unnecessarily and the curing buyer to notify the seller of the curative performance as soon as possible in order to cut off the seller's ability to avoid the contract.<sup>80</sup>

#### **3.3.1.2 Generic goods**

In situations where the buyer may easily obtain a substitute performance, notice must be given promptly immediately. Where the buyer has not made a substitute purchase and must

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<sup>76</sup> Huber (n 24) para 69, 742.

<sup>77</sup> Müller-Chen (n 20) para 29, 761; Plate (n 20) para 3.2.

<sup>78</sup> Müller-Chen (n 20) para 29, 760.

<sup>79</sup> *ibid* 760.

<sup>80</sup> Jonathan Yovel, 'Comparison between provisions of the CISG (Seller's Right to Remedy Failure to Perform: Article 48) and the counterpart provisions of the PECL (Articles 8:104 and 9:303)' (March 2005) 27 <<http://www.cisg.law.pace.edu/cisg/biblio/yovel48.html>> accessed 23 February 2015.



make enquiries as to whether he can obtain substitute performance from other sources then the reasonable period will be longer.<sup>81</sup>

### **3.3.1.3 Goods of a perishable or seasonal nature**

If the delivered goods are of a perishable or seasonal nature, the reasonable time to declare the contract avoided should be set shorter than if they are of a durable type. Obviously, this is because the value of the goods might deteriorate as time passes or they cannot be sold if the buyer waits for too long before cancelling the contract.<sup>82</sup> For these reasons, notice must be given without unnecessary delay, that is, almost instantaneously.<sup>83</sup> In a sale of women's clothes, it was ruled that six weeks after delivery was an unreasonable time of avoidance as the goods were of a seasonal nature; a notification sent six weeks after the proposed delivery date has not been made in due time because the buyer is only granted a short timeframe of a few days.<sup>84</sup> In another case of durable goods, an Italian buyer of a used car was allowed to avoid the contract three months after she discovered the car was previously stolen and the title could not be transferred. The court accepted the time as being pertinent to the difficulties and the various inspections required.<sup>85</sup>

### **3.3.1.4 Market conditions and speculative risks**

The reasonable time concept in Article 49(2) is supposed to exclude speculation on the part of the buyer; it is a similar case for the seller under Article 64(2). It seeks to prevent the possibility for the buyer to initially demand the potentially profitable purchase price and then,

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<sup>81</sup> Koch (n 11) para III.

<sup>82</sup> Camilla Baasch Andersen, 'Selected Notice Requirements under CISG, PECL and UNIDROIT Principles: CISG Articles 39 and 26; UNIDROIT Principles Articles 1.9, 3.14, 7.3.2.; PECL Articles 1.303, 3.304, 4.112, 9.303, 13.104' (November 2004) <<http://www.cisg.law.pace.edu/cisg/biblio/andersen2.html>> accessed 23 February 2015.

<sup>83</sup> Koch (n 11) para III; Baasch Andersen (n 82).

<sup>84</sup> *Women's Clothes Case* District Court Stuttgart, Germany (13 August 1991).

<sup>85</sup> *Automobile Case* District Court Freiburg, Germany (22 August 2002).

after the failure of this attempt, release the goods to the seller.<sup>86</sup> Giving the buyer a lengthy period where the goods are subjected to rapid price fluctuations may mean that the buyer will speculate at the seller's risk and reject the goods if the price is falling (and demand repayment or refuse to pay the price) but retain the goods if the price is rising (and keep the profit).<sup>87</sup>

### **3.3.2 Circumstances that justify extensions of reasonable time**

#### **3.3.2.1 Breaches other than late delivery or late performance by the buyer**

The most important factor that may affect the length of a reasonable period is the nature of the breach. It seems to be widely accepted that the length of the reasonable time under Article 49(2)(b) should be set rather longer than that under Article 49(2)(a).<sup>88</sup> Giving a lengthy period in this case is because the buyer's decision to declare the contract avoided will be subject to additional factors that must be taken into account and which make it more difficult than in the case of late delivery.<sup>89</sup> A reasonable time to avoid the contract should include, but should not be limited to, an opportunity for the buyer to examine the goods and give notice of defects under Article 39(1), the type of goods and type of defect, as well as any arrangements fixed between parties and the behaviour of the seller after giving the notice of defects.<sup>90</sup> This requires that the buyer has fully appreciated the existence, extent and scope of consequences of a breach of contract in order to be capable of assessing whether there is actually a fundamental breach of contract that justifies avoidance of contract under Article 49(1)(a) CISG.<sup>91</sup>

It has been noted that there is a trend in the case law to consider periods of about a month (and sometimes even more) as 'reasonable' while periods of several months are regarded as

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<sup>86</sup> *Coke Case* (n 75).

<sup>87</sup> Huber (n 24) para 69, 742; Müller-Chen (n 20) para 29, 760.

<sup>88</sup> Huber (n 24) para 77, 744; Müller-Chen (n 20) para 31, 762.

<sup>89</sup> Müller-Chen (n 20) para 31, 762.

<sup>90</sup> *ibid* 762.

<sup>91</sup> *ibid* para 34.

unreasonable.<sup>92</sup> Moreover, one court has stated that, generally, a period of one to two months is necessary and reasonable for the buyer to examine the situation sufficiently unless there is an additional special factor that would objectively justify either an extended or a reduced period.<sup>93</sup> However, there is still considerable reluctance to establish a rule of one cut-off period as a universally reasonable time to declare the contract avoided as the matter should be decided in light of the facts of the individual case.<sup>94</sup>

### **3.3.2.2 Interrelation with other CISG provisions**

There appear to be many factors that, if linked in with the ‘other-than-late-delivery-breach’, will result in an expansion of the reasonable time period due to their interrelation with other CISG provisions, in particular, Articles 38, 39, 40, 43, 46, 47 and 48.

There are two approaches in the CISG’s jurisprudence that deal with the situations that may result from a lengthy period to declare the contract avoided. The first approach applies the basic rule that the reasonable period begins to run after the buyer knew or ought to have known of the breach (of Article 49 lit (b)(i) CISG). The period may then be extended by simply granting the aggrieved party an additional period of time which is necessary for an applicable action (for example, curing the defect) to the period which would normally be regarded as reasonable in the sense of Article 49(2)(b)(i).<sup>95</sup>

The same result can be reached by following another approach which only lets the reasonable period of time begin to run after the expiry of the period necessary for interrelated remedies (such as the cure period).<sup>96</sup> In fact, the mechanism for determining the starting point of the reasonable time in Article 49(2)(b) (i, ii, and iii) suggests that the aggrieved buyer should not

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<sup>92</sup> Huber (n 24) para 77, 744.

<sup>93</sup> *Packaging Machine Case* Bundesgericht (Federal Supreme Court) Switzerland (18 May 2009) <<http://cisgw3.law.pace.edu/cases/090518s1.html>> accessed 27 March 2015.

<sup>94</sup> Huber (n 24) para 77, 745.

<sup>95</sup> Müller-Chen (n 20) 762 para 32; Huber (n 24) para 78, 745; Koch (n 11) para III.

<sup>96</sup> Huber (n 24) para 78, 745.

be deprived of his right of avoidance unless he had actual knowledge of the fundamentality of the breach or he was negligent in not getting such knowledge.<sup>97</sup>

Article 49(2)(b)(ii) and (iii) follow the second approach by providing examples of two situations where the buyer has proceeded under Article 47 (fixing a *Nachfrist* for the cure) or if the seller has used the procedure of Article 48(2) in order to offer a cure then the reasonable period will only begin to run after the expiry of the *Nachfrist* period or cure period respectively.

However, this issue is not so clear in the case law regarding reasonable time for avoidance in cases of non-conformity. A strict interpretation of Article 49(2)(b)(i) CISG does not allow the granting of an additional period for the aggrieved buyer in order to assess the fundamentality of the delivery of non-conforming goods.<sup>98</sup>

### **3.3.2.3 Reasonable time in cases of non-conformity**

If the buyer wishes to declare avoidance based on non-conformity of the goods, Articles 38 and 39 of the Convention will apply. The issue of the reasonable time to declare avoidance, in this situation, has caused many disputes in several decisions, particularly from Austrian and German courts.<sup>99</sup> Article 38(1) CISG imposes on the buyer an obligation to ‘examine the goods, or cause them to be examined within as short a period as is practicable in the circumstances’. Article 39(1) CISG requires the buyer to give notice to the seller specifying the nature of the lack of conformity within a reasonable time after he has discovered it or ought to have discovered it. In any event, at the latest, this should be within a period of two

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<sup>97</sup> Article 49(2)(b)(ii) and (iii) provide examples of two situations where the buyer has proceeded under Article 47 (fixing a *Nachfrist* for the cure) or if the seller has used the procedure of Article 48(2) in order to offer cure, the reasonable period will only begin to run after the expiry of the *Nachfrist* period or cure period respectively.

<sup>98</sup> Ari Korpinen, ‘On Legal Uncertainty Regarding Timely Notification of Avoidance of the Sales Contract’ (2005) 1 NJCL, para 2.2; Daniel Girsberger, ‘The Time Limits of Article 39 CISG’ (2005-06) 25 Journal of Law and Commerce 241.

<sup>99</sup> Girsberger (n 98) 241; Baasch Andersen (n 3) para II.

years from the date on which the goods were actually handed over to the buyer unless this time limit is inconsistent with a contractual period of guarantee. The consequences of a buyer's failure to satisfy the requirement of a non-conformity notice are very severe. As a rule, the buyer loses the right to all remedies for a claimed lack of conformity for not giving the seller adequate notice.<sup>100</sup> The dispute that has arisen is whether the time limit for notifying non-conformity and the time limit for notifying avoidance are being triggered at the same or at different points in time. There are two different viewpoints on this issue in CISG case law.

One view is that the time limits for notice of avoidance and notice of the defect under Article 39(1) CISG begin to run simultaneously and coincide in length. A Swiss court ruled that, 'if the buyer wishes to declare the contract avoided, it must do so within the same time requested to give due notice of the lack of conformity under Article 39(1) CISG'.<sup>101</sup> Thus, the buyer may lose the right to avoid the contract under Article 49(2)(b)(i) CISG if he submits the notice of avoidance only after the notice of non-conformity.<sup>102</sup> Along the same lines, a Swiss court ruled that a buyer wishing to declare a contract avoided based on non-conformity must make the declaration of avoidance within the same time as that required to give notice of the lack of conformity under Article 39(1).<sup>103</sup> In essence, the time contemplated by Article 49 in cases of non-conforming goods is governed by the timing requirements of Article 39.<sup>104</sup> This ruling deprives the buyer from considering possibilities of non-avoidance remedies as long as it is necessary to declare avoidance of contract by giving notice of defects.

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<sup>100</sup> There are two exceptions for this rule provided in Articles 40 and 44 CISG.

<sup>101</sup> *Saltwater Isolation Tank Case* Commercial Court Zürich, Switzerland (26 April 1995).

<sup>102</sup> Korpinen (n 98) 5-6.

<sup>103</sup> *Saltwater Isolation Tank Case* (n 101).

<sup>104</sup> Korpinen (n 98) 5-6.

Another view is that '[t]he time limits for notice of avoidance and notice of the defect under Article 39(1) CISG begin to run simultaneously, but only in exceptional cases coincide in length'.<sup>105</sup> In this regard, an Italian court ruled that:

[T]he starting point of the time limit for declaring avoidance is not the same moment as that of the time limit for giving notice of nonconformity ... whereas non-conformity has to be notified as soon as it is discovered or ought to have been discovered, avoidance has to be declared only after it appears that the non-conformity amounts to a fundamental breach which cannot otherwise be remedied.<sup>106</sup>

Similarly, a German court found that the buyer had declared the contract avoided within a reasonable time (Article 49(2)(b) CISG) even though approximately five weeks had elapsed between the delivery of the repaired furniture and the declaration of avoidance of the contract. This was because '[t]he time period starts when the buyer receives the cured delivery, thus, as soon as the buyer knows or ought to have known of the breach of contract'.<sup>107</sup>

The latter view seems to prevail over the former one among scholars because it gives regard to the international character of the Convention and to the observance of good faith in international trade as required in Article 7(1) CISG.<sup>108</sup> In addition, it is reconcilable with the opinion of the CISG's advisory council of scholars<sup>109</sup> about the interrelation between Article 38 and 39 CISG.<sup>110</sup>

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<sup>105</sup> Koch (n 11) section III; Will (n 5) 2.2.2.1.

<sup>106</sup> *Machinery Case* District Court Busto Arsizio, Italy (13 December 2001).

<sup>107</sup> *Furniture case* (n 73).

<sup>108</sup> Korpinen (n 98) 5-6.

<sup>109</sup> The CISG Advisory Council (a group of legal scholars that address controversial unresolved issues relating to the CISG) somewhat clarified this point in their report, stating that the period for examination of the goods under Article 38 and the period for giving notice under Article 39 must be distinguished and kept separate even when the facts of the case would permit them to be combined into a single period for giving notice for avoidance. See CISG Advisory Council, 'Opinion No 2' (Pace University CISG Database, 2004) <<http://www.cisg.law.pace.edu/cisg/CISG-AC-op2.html>> accessed 24 March 2014.

<sup>110</sup> Lachmi Singh, 'United Nations Convention on Contracts for the International Sale of Goods (1980) (CISG): An examination of the buyer's right to avoid the contract and its effect on different sectors of the (product) market' (February 2006) para 3.4 <<http://www.cisg.law.pace.edu/cisg/biblio/singh.html>> accessed 20 July 2015.

### 3.3.2.4 Bad faith seller

There is an exception to the buyer's duty to inspect the goods and give notice of lack of conformity according to Article 39 CISG.<sup>111</sup> This exception is provided in Article 40 CISG and may affect the buyer's right to avoid the contract because it relieves the buyer of the notice requirements when a lack of conformity relates to facts of which the seller 'knew or could not have been unaware'.<sup>112</sup> In just such a case, a German court found that the buyer had not lost his right to rely on the non-conformity of delivered wine, which was not of merchantable quality since it contained 9% water, even though the buyer did not examine the wine for water after delivery. In the Court's opinion, the seller's actual or presupposed knowledge of water additions in the defective wine, which he did not disclose to the buyer, constituted wilful deceit.<sup>113</sup>

Similarly, paragraph (2) of Article 43 CISG exempts the buyer from the notice requirement for a claim related to delivery of goods burdened with rights of third parties if the seller has actual knowledge of the right or claim of the third party and the nature of it.<sup>114</sup> A question may arise whether the seller's actual knowledge of the rights of third parties has any relaxation effects on the buyer's failure to declare avoidance within a reasonable time. It would arguably be permissible under the CISG's principle of good faith to deny protection to a bad faith seller, who has concluded a contract via his concealment.

### 3.4 Conclusion

The application of the idea of reasonable time as a restriction on the aggrieved party's power to declare the contract avoided under the CISG has caused a level of uncertainty before some

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<sup>111</sup> There is another exception in Article 44 which entitles the buyer to reduce the price or claim damages for loss of profit if he has a reasonable excuse for his failure to give the required notice according to Article 39 and paragraph (1) of Article 43; Honnold (n 21) 275.

<sup>112</sup> Honnold (n 21) 275.

<sup>113</sup> *Wine Case* District Court Trier, Germany (12 October 1995).

<sup>114</sup> Honnold (n 21) para 271.

courts and tribunals due to the varied conception of what constitutes a reasonable time. The attempt to determine a specific period as reasonable can be seen as lacking a legal foundation because the idea of reasonable time is meant to be flexible in order to respond to the requirements of international trade standards. Thus, what constitutes a reasonable time in one case might be unreasonable in another. However, the idea of reasonableness is not an arbitrary concept as it needs to be understood in the light of the CISG's policies and principles, in particular, the protection of parties' interests of certainty in concluded contracts and the good faith principle. Thus, in assessing the reasonable time of giving notice within what seems like a long period, a court should consider two facts before it decides whether that period constitutes an unreasonable delay and deprives the avoiding party of its right of avoidance. These facts are the breaching party's interest in certainty and whether the breaching party is unworthy of protection.

In terms of the first, it is not the passage of time that results in barring the aggrieved party from his right of avoidance. Rather, it is how the passage of time has affected the legitimate interests of the party in breach. Moreover, the court should consider whether the delay by the avoiding party was excusable, for example, due to difficulties in judging the seriousness of the breach, or whether he hesitated too long before declaring the contract avoided.

As for the second, ie barring the bad faith party from getting benefits to the other party's detriment, the courts should also consider whether the breaching party is unworthy of protection due to his knowledge of the breach as this might be tantamount to bad faith or unfair dealing, or whether the avoiding party intended to speculate on the breaching party's interests. Observance of both these policies among practitioners may help to bring about the uniform application of the reasonable time concept.



## Chapter Four: The theoretical bases of fundamental breach

The concept of fundamental breach is the ‘linchpin’ in the Convention’s system of remedies. It plays a crucial role within the remedial system of the CISG. Various remedies available to the buyer and the seller, as well as certain aspects of the passing of risk, depend on this concept.<sup>1</sup> The Convention defines fundamental breach in Article 25 CISG. However, the precise meaning of this legal definition is still disputed in CISG literature. The legal definition provides for several elements such as detriment, substantially to deprive and foreseeability by a reasonable person, and these expressions, in their turn, lack a precise meaning. This makes it hard to predict the fundamentality of the breach.<sup>2</sup> Fundamental breach has also been criticised for its generality and ambiguity.<sup>3</sup> This chapter aims to provide a theoretical understanding of this concept throughout its history and scholarly writing as well as an analysis of its elements: detriment and foreseeability.

### 4.1 Historical background

The term ‘fundamental breach’ has undergone substantial changes over the years of its drafting history.<sup>4</sup> A number of scholars have scrutinized the historic development of the

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<sup>1</sup> Leonardo Graffi, ‘Case Law on the Concept of “Fundamental Breach” in the Vienna Sales Convention’ (2003) 33 *International Business Law Journal* 338, 338; Bruno Zeller, ‘Fundamental Breach and the CISG: A Unique Treatment or Failed Experiment’ (2004) 8 *Vindobona Journal of International Commercial Law and Arbitration* 81, 82; Franco Ferrari, ‘Fundamental Breach of Contract under the UN Sales Convention: 25 Years of Article 25 CISG’ (Spring 2006) 25 *Journal of Law and Commerce* 489, 489ff; Ulrich G Schroeter, ‘Article 25’ in Ingeborg Schwenzer, *Schlechtriem and Schwenzer, Commentary on the UN Convention on the International Sale of Goods (CISG)* (3rd edn, OUP Oxford 2010) 398, para 6, 402; Andrea Björklund, ‘Article 25’ in Stefan Kröll, Loukas A Mistelis and Maria del Pilar Perales Viscacillas (eds), *The United Nations Convention on Contracts for the International Sale of Goods* (CH Beck-Hart-Nomos 2011) 333, para 2, 334.

<sup>2</sup> *Benjamin’s Sale of Goods* (Judah Philip Benjamin and others (eds), Sweet & Maxwell 1997) para 18-116 as cited in Björklund (n 1) para 9, 337.

<sup>3</sup> Graffi (n 1) 337.

<sup>4</sup> Forerunners and Drafts: Article 55(3) of the Draft Uniform Law on International Sales of Goods (Corporeal Moveables) (as adopted by the Governing Council of UNIDROIT, 1939); Article 15 of the UNIDROIT Draft Uniform Law on the International Sale of Goods, as revised in 1956 by the Special Commission appointed by the 1951 Hague Diplomatic Conference; Article 10 Convention Relating to a Uniform Law for the International Sale of Goods (1 July 1964) 834 UNTS 169 (ULIS); Article 9 UNCITRAL Working Group on the International Sale of Goods, 7<sup>th</sup> Session, Geneva, 1976) UN Doc A/CN.9/116; Article 8 UNCITRAL Draft, 10<sup>th</sup> Plenary Session (Vienna, 1977); Article 23 of the UNCITRAL, ‘Report of the UNCITRAL on the work of its eleventh session (New York, 30 May – 16 June 1978)’ (1978) IX *Yearbook* 11 (New York Draft 1978).

notion of fundamental breach to determine the most accurate reflection of this concept in practice. Their conclusions are that judges are expected to articulate principled standards for what determines fundamental breach.<sup>5</sup> In order to provide a general understanding of its development and the idea behind it, the history of fundamental breach will be addressed through three sections: pre-CISG attempts, fundamental breach under CISG and fundamental breach as developed under other international instruments that came after CISG.

#### **4.1.1 Pre-CISG attempts**

Fundamental breach within pre-CISG efforts can be grouped into 4 stages of development: breach of essential obligation; fundamental breach of contract; issues raised at the Hague 1964 Conference; and preparatory work for the Convention.

##### **4.1.1.1 Breach of essential obligation**

The early Rome Drafts (1939, 1951) did not contain any provisions that referred to fundamental breach as a central concept that entitled the aggrieved party to avoid the contract. Rather, they adopted a fragmented remedial system similar to that of traditional English common law which distinguishes between warranty and condition. Furthermore, the contract could only be avoided where the violated term could be classified as an essential condition.<sup>6</sup> An obligation of the seller is an essential condition of the contract if without it the

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<sup>5</sup> Shinichiro Michida, 'Cancellation of Contract' (1979) 27 *American Journal of Comparative Law* 279, 281ff; Gyula Eörsi, 'A Propos the 1980 Vienna Convention on Contracts for the International Sale of Goods' (Spring, 1983) 31(2) *The American Journal of Comparative Law* 333, 337ff; Olof Clausson, 'Avoidance in Non-payment Situations and Fundamental Breach under The 1980 UN Convention on Contracts for the International Sale of Goods' (1984-1986) 6(1) *New York Law School Journal of International and Comparative Law* 93, 97; Michael Will, 'Article 25' in CM Bianca and MJ Bonell (eds), *Commentary on the International Sales Law: The 1980 Vienna Sales Convention* (Giuffrè 1987) 205, para 1, 206ff; Robert Koch, 'The Concept of Fundamental Breach of Contract under the United Nations Convention on Contracts for the International Sale of Goods (CISG)' (1999) *Kluwer Law International*, 177, 343; Anselmo Martínez Cañellas, 'El Incumplimiento Esencial En El Contrato De Compraventa Internacional De Mercaderías' (PhD Thesis, Universitat de les Illes Balears, Palma de Mallorca, 2001) capítulo cuarto, 215ff; Darren Peacock, 'Avoidance and the Notion of Fundamental Breach Under the CISG: An English Perspective' (2003) 8 *International Trade and Business Law Review* 95, 98.

<sup>6</sup> Will (n 5) 206; Peacock (n 5) 98.

buyer would not have concluded the contract.<sup>7</sup> The essentiality in this definition refers to the importance of a particular contractual obligation, not to the breach.

#### **4.1.1.2 Fundamental breach of contract**

During the preparatory work for the ULIS in 1951, the Working Group at The Hague Conference noticed that the ULIS provisions did not fulfil the higher aim of saving the contract since they allowed avoidance of the contract for breach of essential condition, even in circumstances where the breach caused relatively little or only negligible damage.<sup>8</sup> In response to these criticisms, the Danish representative suggested the concept of fundamental breach of any contractual duty instead of the notion of breach of a fundamental obligation as a prerequisite for the availability of the aggrieved party's right to avoid the contract.<sup>9</sup> This notion was accepted and included in Article 15 of the 1956 ULIS draft. The draft suggests a distinction between fundamental and non-fundamental breach. Article 15 of the draft provides that:

A breach of the contract shall be deemed to be fundamental wherever the party knew or ought to have known, at the time the contract was made, that the other party would not have contracted had he foreseen that such breach would occur.<sup>10</sup>

Accordingly, there are two elements that render a breach of contract to be fundamental:

- i. the fact that the innocent party would not have concluded the contract had he had foreseen the breach;
- ii. real or supposed knowledge of the breaching party of the fact stated above (the other

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<sup>7</sup> Article 55(3) of the 1939 Draft (n 4): 'An obligation of the seller is an essential condition of the contract where it appears from the circumstances that the buyer would not have concluded the contract without such undertaking.' Koch (n 5) at note 306.

<sup>8</sup> Peacock (n 5) 99.

<sup>9</sup> *ibid* 99.

<sup>10</sup> Diplomatic conference on the unification of law governing the international sale of goods (Draft Uniform law on the international sale of goods, The Hague, 2-25 April 1964) (The Hague 1966) doc V, 1, 9; Koch (n 5) at note 397.

party would not have concluded the contract if he had foreseen the breach) at the time of concluding the contract.

The difficulty that may arise when applying this definition is in deciding the circumstances in which the breaching party will be deemed to know or can be supposed to know about the inner intention of the other party and how such knowledge could be proved. The definition of Article 15 of the 1956 ULIS draft was criticized for being framed in a very subjective fashion. In particular, it would be very difficult to prove that the party who has committed the breach of the contract should have known what the other party would have done if he had foreseen the breach at the time of the conclusion of the contract.<sup>11</sup> In addition, the criterion for distinguishing between fundamental and less serious types of breach has not been well chosen as the internal intentions of the parties would be difficult to ascertain and still more difficult to demonstrate.<sup>12</sup>

#### **4.1.1.3 At the 1964 Hague Conference**

At the 1964 Hague Conference, Article 15 of the 1956 ULIS draft was developed further. The amendment made to Article 15 replaced the term ‘other party’ with ‘a reasonable person in the same situation as the other party’. This alteration was intended to add a degree of objectivity to the fundamental breach concept. The other elements were maintained. Thus, Article 10 ULIS categorizes a breach of contract as being fundamental ‘wherever a party in breach knew, or ought to have known, at the time of the conclusion of the contract, that a reasonable person in the same situation as the other party would not have entered into the

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<sup>11</sup> See the Austrian Federal Government observations on this article. It suggested that substitution of the words ‘should have supposed’ for the words ‘should have known’ would be some improvement. Diplomatic Conference (n 10) 1, 108.

<sup>12</sup> See the observations of the Government of the Netherlands on this article. It suggested a more objective criterion: ‘A breach of the contract is fundamental either by virtue of an express provision of the law or because its importance which is such as to justify the avoidance of the contract.’ Diplomatic Conference (n 10) 1, 138.

contract if he had foreseen the breach and its effects'.<sup>13</sup> Although this alteration contained both elements of subjectivity and objectivity, the follow-up definition was still an object of criticism on the grounds that it was too complex and its subjective standards would be difficult to apply.<sup>14</sup>

#### **4.1.1.4 Preparatory work for the Convention**

During the preparatory work for the Convention, the UNCITRAL Working Group was primarily concerned with formulating a non-subjective definition for the concept of fundamental breach. It proposed the single objective criterion of whether the breach substantially impaired the value of the performance required by the contract.<sup>15</sup> This objective test was further developed throughout the ten years of preparatory work on the CISG and at the Vienna Conference.<sup>16</sup> At the drafting stage, numerous attempts were made and rejected.<sup>17</sup> The definition of fundamental breach which was ultimately set out in Article 23 of the 1978 draft read as follows:

A breach committed by one of the parties is fundamental if it results in substantial detriment to the other party unless the party in breach did not foresee and had no reason to foresee such a result.

This new formulation aimed to eschew, as much as possible, the flaws identified in Article 10 ULIS. The following three changes can be noted:

- i. The subjective element that the reasonable person of the same kind of the innocent party 'would not have concluded the contract had he foreseen the breach and its results' was replaced with a purely objective one of 'substantial detriment'.

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<sup>13</sup> Article 10 ULIS (n 4). For a comparison between Article 10 ULIS and Article 25 CISG see Clausson (n 5) 96.

<sup>14</sup> Koch (n 5) 309.

<sup>15</sup> *ibid* 272.

<sup>16</sup> Schroeter (n 1) para 4, 401.

<sup>17</sup> *ibid* para 8, 403.

- ii. The fundamentality of the breach is still conditioned on the knowledge of the breaching party of the result of the breach. However, it is introduced in the way of passive foreseeability in order to exempt the non-breaching party from the burden of proving this knowledge.<sup>18</sup> It would be extremely difficult for the non-breaching party to prove that the party in breach foresaw or had reason to foresee such a result. Therefore, the prescribed breach is fundamental unless the breaching party did not foresee and had no reason to foresee such a substantial detriment of the breach.
- iii. The time at which it was possible to foresee the result is irrelevant and UNCITRAL did not consider it necessary to specify at what moment the party in breach should have foreseen or had reason to foresee the consequences of the breach.<sup>19</sup>

The definition of fundamental breach in Article 23 CISG 1978 draft was based on the concept of substantial detriment to the other party. This was considerably different to the text of the Convention relating to a Uniform Law on the International Sale of Goods which linked the idea of fundamental breach to the fact that the party in breach knew, or ought to have known, at the time of the conclusion of the contract that a reasonable person in the same situation as the other party would not have entered into the contract if he had foreseen the breach and its effects.<sup>20</sup>

The test of fundamental breach in Article 23 of the 1978 draft Convention was seen as a material or substantial breach test and as being more flexible. Furthermore, 'it was both simple and commensurate with striking a reasonable balance between the parties'.<sup>21</sup>

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<sup>18</sup> Based on the Philippines' and the United States' delegates suggestion to UNCITRAL; See Koch (n 5) 272.

<sup>19</sup> Koch (n 5) 272.

<sup>20</sup> Article 10 ULIS (n 4).

<sup>21</sup> United Nations Convention on Contracts for the International Sale of Goods UN Doc A/CONF.97/SR.6, Canada delegation on article 23 Doc C (7); John Honnold, *Documentary History Of The Uniform Law For International Sales: The Studies, Deliberations, And Decisions That Led To The 1980 United Nations Convention With Introductions And Explanations Documentary* (Kluwer Law 1989) 741; UNCITRAL, 'Comments by Governments and International Organizations on the Draft Convention on International Sale of

However, there were some concerns about the precise meaning of ‘substantial detriment’.<sup>22</sup> Must the innocent party wait until he had suffered substantial detriment in order to avail himself of the remedies based on fundamental breach?<sup>23</sup> Will the subjective element introduced by the foreseeability requirement, which is based on the circumstances of the party in breach, prevent difficulties in application?<sup>24</sup> Would it ever be possible to determine whether a breach was fundamental without referring to the terms of the contract?<sup>25</sup> These were some of the important questions that obsessed the participant delegations at the Vienna Conference as they sought to influence a new formulation for the concept of fundamental breach.

#### 4.1.2 The definition of fundamental breach in Article 25 CISG

##### 4.1.2.1 General view

In response to these concerns and with attempts to maintain the progress made in Article 23 1978 draft, the fundamental breach concept took its final shape in Article 25 CISG.<sup>26</sup> The

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Goods’ UN Doc A/CN.9/125 20, para 5, 6; VIII Yearbook 109, 118; The International Chamber of Commerce commented that ‘the present definition represents a considerable improvement.’ See A/CN.9/125, para 12; VIII Yearbook 137 cited in Michida (n 5) 284; Jacob S Ziegel, ‘The Remedial Provisions in the Vienna Sales Convention: Some Common Law Perspectives’ in Nina M Galston and Hans Smit (eds), *International Sales: The United Nations Convention on Contracts for the International Sale of Goods* (Matthew Bender 1984) chapter 9, 9-1 to 9-43, 9-15.

<sup>22</sup> The delegation of the United Kingdom proposed: ‘A breach committed by one of the parties is fundamental if it results in substantial detriment to the other party unless *at the time when the contract was concluded* the party in breach did not foresee and had no reason to foresee such result. *A breach does not result in substantial detriment to the other party if damages would be an adequate remedy for him.*’ The Pakistani delegation proposed replacing the words ‘if it results in substantial detriment to the other party’ with the words ‘if it results in such detriment to the other party as would basically change the terms of the transaction.’ See Koch (n 5) 279 and 186 respectively.

<sup>23</sup> The delegation of the former Czechoslovakia proposed that: ‘A breach of contract is fundamental if the party in breach knew or ought to have known, in the light of the reasons for the conclusion of the contract, or any information disclosed at any time before or at the conclusion of the contract, that the other party would not be interested in performance in case of such a breach’; Koch (n 5) 275.

<sup>24</sup> The Egyptian delegation proposed that: ‘A breach committed by one of the parties is fundamental if it results in substantial detriment to the other party unless the party in breach *proves that he did not foresee such a result and that a reasonable person of the same kind in the same circumstances would not have foreseen it.*’; Koch (n 5) 276.

<sup>25</sup> The delegation of the Federal Republic of Germany proposed that: ‘A breach committed by one of the parties is fundamental if, *having regard to all express and implied terms of the contract*, the breach results in substantial detriment to the other party unless the party in breach did not foresee and had no reason to foresee such result’; Koch (n 5) 278.

<sup>26</sup> New York Draft 1978 (n 4) UN Doc A/CONF.97/5 in Honnold (n 21) 382-391.

amended definition of fundamental breach in Article 25 CISG is as follows:

A breach of contract is fundamental if it results in such detriment to the other party as substantially to deprive him of what he is entitled to expect under the contract, unless the party in breach did not foresee and a reasonable person of the same kind in the same circumstances would not have foreseen such a result.

The revisions of Article 23 of the 1978 Convention draft were perceived as a compromise between various proposals from two conflicting views at the Diplomatic Conference. One group of states wanted to extend objective detriment to the injured party as the determining factor and therefore wished to keep the UNCITRAL formulation in order to establish an unmistakable criterion.<sup>27</sup> The other group of states wanted to place more emphasis on the injured party's interest in the fulfilment of the obligation in question, independently of objectively measurable (and provable) damages and having regard to all express and implied terms of the contract.<sup>28</sup> The compromise that was finally reached in the Diplomatic Conference in Vienna was that whether a breach of contract amounted to a fundamental breach did not depend on the amount of the damages but rather on the importance of the interests of the innocent party in performance which the contract and its individual terms actually created.<sup>29</sup> Accordingly, the elements that constitute a fundamental breach in the CISG are the following:

- i. An objective element represented in a detriment that results in substantial deprivation of the contractual expectation.

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<sup>27</sup> See Honnold (n 21) (Canadian rep (cmt 12), Swedish rep (cmt 13), Spanish rep (cmt 16)) 741.

<sup>28</sup> At the first committee deliberations, the delegate of Pakistan advocated that the expression 'substantial detriment' lacked precision. It was therefore replaced in its amendment (UN Doc A/CONF.97/C.1/L.99) by a more explicit term. He wished to emphasize the idea of precision and not the actual wording of his text, which he was prepared to revise if necessary. The Federal Republic of Germany also advocated that the criterion should be the injured party's expectations as reflected in the circumstances of the particular contract in question. Peter Schlechtriem, *Uniform Sales Law: The UN-Convention on Contracts for the International Sale of Goods*, (Manz 1986) 59.

<sup>29</sup> Schlechtriem (n 28) 59; Hossam El-Saghir, 'Fundamental breach: Remarks on the manner in which the Principles of European Contract Law may be used to interpret or supplement Article 25 CISG' (July 2000) <<http://www.cisg.law.pace.edu/cisg/text/peclcomp25.html>> accessed 23 July 2014.



- ii. A subjective-objective element represented in the passive knowledge or non-foreseeability of the result of the breach by the breaching party (subjective), or a typical reasonable person in the same circumstances as the breaching party (objective).
- iii. Unlike Article 10 ULIS, Article 25 CISG makes no reference to the moment at which the obtained knowledge by the breaching party could affect the fundamentality of the breach.

The relationship between the first two elements is not entirely clear in the CISG literature. It is unclear whether the non-foreseeability is a condition to engender the fundamental breach or if it serves as a clause to exempt the breaching party of responsibility if his breach was fundamental.<sup>30</sup> The omission of the time of required foreseeability is an added ambiguity of the fundamental breach definition.

#### **4.1.2.2 Analytic framework**

The later definition in Article 25 CISG appears to be a stricter test than the one in Article 23 of the 1978 Convention draft. However, Article 25 CISG presents a complex definition of fundamental breach and it is frequently criticized for its wording, style and structure. In terms of its wording, the definition of Article 25 CISG is in ‘extremely vague and ambiguous’ language.<sup>31</sup> It is also somewhat ‘lacking in detail’.<sup>32</sup> The use of abstract concepts and general clauses, such as ‘what to expect’, ‘substantially deprive’ and ‘reasonable person’, delegates to courts and adjudicators an unbounded discretion rather than specifies outcomes that must

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<sup>30</sup> Schroeter (n 1) para 36, 416.

<sup>31</sup> Michael Joachim Bonell, ‘The UNIDROIT Principles of International Commercial Contracts and the Vienna Sales Convention (CISG): Alternatives or Complementary Instruments’ (1996) 26 *Uniform Law Review* 26, 28.

<sup>32</sup> Michael Bridge, *The International Sale of Goods Law and Practice* (2<sup>nd</sup> edn, Oxford University Press 2007) para 11.36, 536.

flow from the described circumstances.<sup>33</sup> This open-textured nature makes it difficult to decide when a breach will be regarded as ‘fundamental’.<sup>34</sup> It is an undisputed fact that such discretion endangers the larger purposes of the uniform application of the Convention.<sup>35</sup>

The particular style in which Article 25 is written means that the meaning of Article 25 is not readily comprehensible because of the circuitous way in which it defines fundamental breach. The identifying question as related to the breach was shifted to what the innocent party was entitled to expect under the contract rather than simply asking what the breaching party was obliged himself to undertake. It will not, on its own, enable judges and practitioners to draw the exact line between fundamental breach and other types of breach.<sup>36</sup>

The structure of the provision contains a chain of cumulative conditions of positive and negative values that may cancel each other out. The affirmed fundamentality of the breach is conditioned by the phrase: ‘if it results in such detriment to the other party’. In turn, the detriment is subject to another condition with a related content that aims ‘substantially to deprive’ the aggrieved party of an unspecified object that ‘he is entitled to expect under the

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<sup>33</sup> Eduardo Grebler, ‘The UN Sales of Goods Convention: Perspectives on The Current State-of-Play’ (2007) 101 *American Society of International Law Proceedings* 407, 411; Paul B Stephan, ‘The Futility of Unification and Harmonization in International Commercial Law’ (Spring 1999) 39 *Virginia Journal of International Law* 743, 774.

<sup>34</sup> *Benjamin’s Sale of Goods* (n 2) paras 18-116 as cited in Björklund (n 1) para 9, 337; Koji Takahashi, ‘Right to Terminate (Avoid) International Sales of Commodities’ (2003) *Journal of Business Law* 102, 124: ‘The CISG rules do not provide a high degree of legal certainty and predictability, inasmuch as they rely upon ambiguous concepts such as “fundamental breach” and “reasonable length”’; Clayton P Gillette and Robert E Scott, ‘The Political Economy of International Sales Law’ (2005) 25 *International Law and Economics* 446, 474: ‘Uncertainty results not only from the many vague standards, but also from the use of ambiguous language that may have different meanings in different cultures’; H Allen Blair, ‘Hard Cases Under The Convention On The International Sale Of Goods: A Proposed Taxonomy Of Interpretative Challenges’ (2011) 21 *Duke Journal Of Comparative and International Law* 269, 313.

<sup>35</sup> Ulrich Magnus, ‘The Remedy Of Avoidance Of Contract Under CISG; General Remarks And Special Cases’ (2005-06) 25 *Journal of Law and Commerce* 423, 426; Paul B Stephan, ‘Does the CISG Fill A Much-Needed Gap?’ (2007) 101 *American Society of International Law* 414, 415; It has been reported that German courts have been particularly reluctant to find certain conduct amounts to fundamental breach while French, Austrian, and USA courts have been more prone to finding a fundamental breach that justifies avoidance of the contract. See: Schlechtriem and Butler, ‘CISG’ (2009) para 115 cited in Andrea Björklund (n 1) 335 at footnotes 15, 16.

<sup>36</sup> Peter Huber, ‘CISG: The Structure of Remedies’ (January 2007) 71 *Rabels Zeitschrift für Ausländisches und Internationales Privatrecht* 13, 25 (Presentation at seminar: ‘The Convention on the International Sale of Goods: The 25th Anniversary: Its Impact in the Past; Its Role in The Future’, German Society of Comparative Law, Private Law Division, Conference 2005 (22-24 September 2005); Grebler (n 33) 411.

contract'. This is followed by an exception, 'unless the party in breach did not foresee', which is then accompanied by another negative exception, 'and a reasonable person of the same kind in the same circumstances would not have foreseen such a result'.<sup>37</sup> Indeed, such convoluted language is very likely to be misunderstood not only by the reasonable businessmen engaged in a sale contract but also by legal professionals. This adds considerable difficulties for lawyers who are seeking to advise their clients on the implications of particular breaches and to the arbitrators and courts in determining whether the defendant was justified in avoiding the contract upon a plaintiff's breach.<sup>38</sup>

#### 4.1.3 Fundamental breach in other international unification instruments

The CISG model concerning avoidance of contract and the definition of fundamental breach has been more or less copied by the PICC, the PECL and the optional CESL.<sup>39</sup> The definition of fundamental non-performance in each of the above corresponds generally to the concept of fundamental breach in the CISG. Fundamental non-performance has been defined in terms of foreseeable 'substantial deprivation of contractual expectation'.<sup>40</sup> The main objective of

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<sup>37</sup> Grebler (n 33) 408.

<sup>38</sup> Ziegel (n 21) 9; Björklund (n 1) para 9, 337; Huber (n 36) 25.

<sup>39</sup> UNIDROIT, *Principles of International Commercial Contracts* (3<sup>rd</sup> edn, 2010) (PICC); Commission on European Contract Law, *Principles of European Contract Law* (Parts I and II revised 1998, Part III 2002) (PECL); Commission, 'Proposal for a Regulation of the European Parliament and of the Council on a Common European Sales Law (CESL)' COM (2011) 635 final.

<sup>40</sup> Article 7.3.1(2) (a) of the UNIDROIT Principles (n 39) describes fundamental breach as 'the non-performance substantially deprives the aggrieved party of what it was entitled to expect under the contract unless the other party did not foresee and could not reasonably have foreseen such result.'; Article 8:103 PECL (n 39), 'A non-performance of an obligation is fundamental to the contract if: ... (b) the non-performance substantially deprives the aggrieved party of what it was entitled to expect under the contract, unless the other party did not foresee and could not reasonably have foreseen that result'; Article 87(2) of the CESL (n 39) 'Non-performance of an obligation by one party is fundamental if: (a) it substantially deprives the other party of what that party was entitled to expect under the contract, unless at the time of conclusion of the contract the nonperforming party did not foresee and could not be expected to have foreseen that result ...' for comparison between article 25 CISG with the UNIDROIT Principles see Robert Koch, 'Commentary on Whether the UNIDROIT Principles of International Commercial Contracts May Be Used to Interpret or Supplement Article 25 CISG' (November 2004) <<http://www.CISG.law.pace.edu/CISG/biblio/koch1.html>> accessed 22 June 2014; For comparison between article 25 CISG with PECL see Editorial remarks by Hossam El-Saghir (July 2000) <<http://www.CISG.law.pace.edu/CISG/text/peclcomp25.html>> accessed 21 June 2014.

fundamental non-performance in the above systems is to empower the aggrieved party with the right to terminate the contract.<sup>41</sup>

However, there are subtle differences as to the wording and linguistic structure of the compared instruments. Article 25 CISG lays down a general criterion for fundamental breach and does not identify situations in which the breach of an obligation is fundamental. In addition, it is silent regarding the issues of the time when the foreseeability is required and the curability of the fundamental breach. This is in contrast to the compared set of principles which wisely added express exemplary situations for fundamental non-performance such as that a strict compliance was the essence of the contract<sup>42</sup> and that the non-performance was intentional or reckless if it gave the aggrieved party reason to believe that he could not rely on the other party's future performance.<sup>43</sup> The time of foreseeability, which the CISG has omitted, is considered to be the time of concluding the contract according to the CESL.<sup>44</sup> The PICC adds two limitations to the availability of the aggrieved party's right to terminate the contract. The disproportionate loss caused to the breaching party compared to the benefit of the injured party arising out of termination<sup>45</sup> and the curability of the breach may limit the aggrieved party's right to terminate the contract in spite of the existence of a fundamental non-performance.<sup>46</sup> It is questionable whether these limitations could rightfully be considered under the CISG according to the CISG's interpretation principles. The safest view seems reluctant to use the parallel concepts of 'fundamental non-performance' of the PICC and

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<sup>41</sup> Article 7.3.1(1) of the UNIDROIT Principles (n 39); Article 9:301(1) PECL (n 39); Article 114(1), Article 134 of the CESL (n 39).

<sup>42</sup> Article 7.3.1(2)(b) of the UNIDROIT Principles (n 39); Article 8:103(a) PECL (n 39); there is no similar provision in the CESL (n 39).

<sup>43</sup> Article 7.3.1(2)(c) of the UNIDROIT Principles (n 39) '[T]he non-performance is intentional or reckless'; Article 8:103(c) PECL 'the non-performance is intentional and gives the aggrieved party reason to believe that it cannot rely on the other party's future performance'; Article 87(2)(b) of the CESL (n 39) 'it is of such a nature as to make it clear that the non-performing party's future performance cannot be relied on.'

<sup>44</sup> Article 87(2)(a) the UNIDROIT Principles and PECL (n 39) are silent on this issue.

<sup>45</sup> Article 7.3.1(2)(e) of the UNIDROIT Principles (n 39), '[T]he non-performing party will suffer disproportionate loss as a result of the preparation or performance if the contract is terminated.'

<sup>46</sup> Article 7.1.4 (2) provides for cure by non-performing party that: 'The right to cure is not precluded by notice of termination.'

PECL as guidance to interpret Article 25 CISG. The interpretation of Article 25 should instead be taken from its wording, its legal history and its interpretation by courts and commentators.<sup>47</sup>

## **4.2 Analysis of fundamental breach**

Under Article 25, the breach must satisfy two conditions in order to be classified as fundamental. The first is an objective condition, that is, ‘it results in such detriment to the other party as substantially to deprive him of what he is entitled to expect under the contract’. The second is a subjective and objective condition represented in the passive knowledge or non-foreseeability of the result of the breach by the breaching party (subjective) or a typical reasonable person in the same circumstances as the breaching party (objective). The substantially depriving breach is not fundamental ‘unless the party in breach did not foresee and a reasonable person of the same kind in the same circumstances would not have foreseen such a result’. The question over what makes a breach fundamental in relation to these two conditions is still controversial in CISG doctrine and the divergent interpretation of such a relationship affects the occurrence of a fundamental breach and the allocation of the burden to prove it.

### **4.2.1 The detriment-foreseeability relationship**

Two main views can be identified as to the relationship between detriment and foreseeability.

#### **4.2.1.1 Foreseeability is a burden of proof rule as a defence**

One view that has been taken from the wording of the ‘unless ...’ part of the above definition is that Article 25 subjects the notion of substantiality of detriment to the notion of

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<sup>47</sup> Schroeter (n 1) para 12, 405; but for a more tolerant stance see Koch (n 40) para IV.

foreseeability of the result.<sup>48</sup> The court should first scrutinize the substantiality of the breach and then deal with the foreseeability issues.<sup>49</sup> The burden of proving substantial deprivation lies on the party claiming to have been harmed. Once he has established substantial deprivation, the burden will shift to the breaching party to show that the extent of the harm was not foreseeable.<sup>50</sup> Even if the avoiding party was substantially deprived of the contractual expectation, the avoidance will not be rightfully declared if the breaching party proves the non-foreseeability of the result. A breach of contract that causes a level of substantial detriment sufficient to deprive the aggrieved party of the benefit of its bargain is not fundamental where the breaching party did not foresee and could not reasonably have foreseen those consequences.<sup>51</sup> Only foreseeable consequences are to be taken into account as a basis for avoidance of contract.<sup>52</sup> Thus, foreseeability is an affirmative defence that serves solely to exempt the breaching party from his liability<sup>53</sup> for the fundamental breach of contract, an additional ‘filter’, or even a kind of limitation comparable to the foreseeability rule in Article 74 CISG which limits liability of the breaching party in exceptional cases where the result of a fundamental breach could not be foreseen for the breaching party or a reasonable person of the same kind in the same circumstances.<sup>54</sup>

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<sup>48</sup> Henry D Gabriel, *Contracts for the sale of goods : a comparison of U.S. and international law* (2<sup>nd</sup> edn, Oxford University Press 2009) 109; Andrew Babiak, ‘Defining “Fundamental Breach” Under the United Nations Convention on Contracts for the International Sale of Goods’ (Spring 1992) 6 *Temple International and Comparative Law Journal* 113, 114; Jianming Shen, ‘Declaring the Contract Avoided: The UN Sales Convention in the Chinese Context’ (Winter 1997) 10(1) *New York International Law Review* 7, 12; Clemens Pauly, ‘The Concept of Fundamental Breach as International Principle to Create Uniformity of Commercial Law’ (1999-2000) 19 *Journal of Law and Commerce* 221, 225.

<sup>49</sup> Pauly (n 48) 225.

<sup>50</sup> *CNC Machine Case* Appellate Court Valais, Switzerland (21 February 2005); Björklund (n 1) 333, para 19, 340.

<sup>51</sup> Babiak (n 48) 120; Shen (n 48) 12.

<sup>52</sup> John Honnold, *Uniform Law for International Sales under the 1980 United Nations Convention* (3rd edn, Kluwer Law International 1999) para 183, 212.

<sup>53</sup> The problem is not really one of ‘liability’, as repeatedly stated, because the injured party may recover damages; Michida (n 5) 279, 283.

<sup>54</sup> Honnold (n 52) 207; Koch (n 40); Babiak (n 48) 121; Grebler (n 33) 409; Peter Huber, ‘Remedies of the buyer’ in Peter Huber and Alastair Mullis (eds), *The CISG: A New Textbook for Students and Practitioners* (Sellier 2007) 216; Björklund (n 1) para 20, 340.

#### 4.2.1.2 Foreseeability is a determiner of the legitimated contractual expectations

The other view can be taken from the historical development of Article 25. It provides that the ‘unless ...’ part of the legal definition of fundamental breach, despite its misleading use, is relevant only for interpreting and assessing the importance of the obligation that has been breached and its significance for the promisee.<sup>55</sup> In the 1976 draft of the Convention, the aggrieved party was burdened with showing that the breach of contract resulted in a substantial detriment to him and that the party in breach foresaw or had reason to foresee such a result.<sup>56</sup> The Philippines objected to this formulation because it was unfair and it would be quite difficult for the injured party to prove, further to the substantial detriment, that the party in breach foresaw or had reason to foresee such a result.<sup>57</sup> In the light of this objection, the wording of the definition was amended to require the breaching party to show that he could not reasonably have foreseen the consequences of his breach.<sup>58</sup> The promisor’s knowledge or foreseeability of the promisee’s expectations, at this stage, was meant to be a burden of proof allocation rule.<sup>59</sup> Foreseeability of substantial detriment was no longer of concern to the avoiding party but a matter to be invoked by the ‘party in breach’ if he wished to deny the fundamentality of his breach.<sup>60</sup> However, this meaning no longer exists under the current version of Article 25 CISG.

The later introduction of the criterion of ‘detriment’ – qualified by a reference to what the promisee is entitled to expect of the contract – marginalized the role of foreseeability as a

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<sup>55</sup> Schroeter (n 1) para 27, 412.

<sup>56</sup> Article 9(8) 1976 Draft (n 4).

<sup>57</sup> The Philippines proposed that the words ‘and the party in breach foresaw or had reason to foresee such a result’ should be deleted. See UNCITRAL, ‘Comments by Governments and International Organizations on the draft Convention on International Sale of Goods’ UN Doc A/CN.9/125 at 42, para 7, VIII Yearbook 127.

<sup>58</sup> After difficult negotiations, the UNCITRAL Draft Convention arrived at Article 23 which states: ‘A breach committed by one of the parties is fundamental if it results in substantial detriment to the other party unless the party in breach did not foresee and had no reason to foresee such a result’ (Secretariat’s Commentary, Official Records, I, 26; for subsequent suggestions see Will (n 5) 208; Ziegel (n 21) 9-18.

<sup>59</sup> Honnold (n 52) para 183, 209; Schroeter (n 1) para 5, 401.

<sup>60</sup> Michida (n 5) 285.

parameter to fundamental breach. Foreseeability, which related to the substantial detriment, had thereby lost its function as a ground for excuse where the result of breach was unforeseeable; it would be unlikely that the party in breach or his platonic reasonable-self had not foreseen the other party's contractual expectation. Given the magnitude of substantial detriment in the CISG which calls for the deprivation in substance of the benefit of the bargain, or even assuming a lower threshold, it would be unimaginative for a contract breaker to claim that he failed to foresee effects of the substantial detriment. Such lack of foresight would be far from being a realistic situation.<sup>61</sup> Thus, the formula of the legal definition starting with 'unless ...' had become superfluous as a burden of proof rule. Once the detriment was proved to substantially deprive the legitimately-expected contractual interests, the breaching party or a reasonable person of the same kind in the same circumstances must have foreseen the detriment.<sup>62</sup> If the breach was proved as fundamental, the promisor would not be believed when alleging that he did foresee the detriment that resulted from his breach.<sup>63</sup> The role of foreseeability is only to interpret the intention of the parties at the time of concluding the contract and ascertaining the importance of an obligation. That is, foreseeability defines the basis of the bargain between the parties and encourages disclosure in order to set the contract price at the right level and diminish the likelihood of a future breach.<sup>64</sup>

Therefore, the detriment or the substantial deprivation characterises the breach as fundamental 'since the foreseeability principle presumably is designed to give [the debtor] an opportunity to give special attention to minor details of performance the importance of which

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<sup>61</sup> Bridge (n 32) 569.

<sup>62</sup> Chengwei Liu, 'Remedies for Non-performance: Perspectives from CISG, UNIDROIT Principles and PECL' (September 2003) para 7.2 and 8.2.3.1 <<http://cisgw3.law.pace.edu/cisg/biblio/chengwei.html>> accessed 21 March 2015.

<sup>63</sup> *Soy Protein Products Case* Canton Appellate Court Basel, Switzerland (22 August 2003); Ingeborg Schwenzer, 'The Right to Avoid the Contract' (2012) 3 *Annals FLB*, Belgrade Law Review 207, 209.

<sup>64</sup> Schroeter (n 1) para 27, 412; Bridge (n 32) 569; Schwenzer (n 63) 209.



he could not otherwise have anticipated'.<sup>65</sup> Relying on a foreseeability element as a defence would come into play only when the particular importance of the obligation breached was in doubt.<sup>66</sup> It has been said that keeping the 'unless...' part was a somewhat unfortunate mistake in the development of the notion of fundamental breach as it gives rise to some confusion over the question of the burden of proof non-foreseeability in the interpretation of Article 25 CISG.<sup>67</sup>

#### **4.2.2 The nature and test of detriment**

The Convention uses the term 'detriment' exclusively in Article 25 and does not provide a definition or even give an example of it. However, the CISG's doctrine has come to the conclusion that the term detriment 'had to be interpreted in a broader sense'.<sup>68</sup> Any narrow construction must be excluded; detriment does not equal damage nor does it equal loss or any similar international or national technical term.<sup>69</sup> The concept of detriment should not be compared with the concept of 'damages' referred to in Article 74 CISG since under this Article a party has a right to claim damages even if the breach is not fundamental (or substantial). The notion of detriment is much broader than that of damage. It comprises all actual and future negative consequences of any possible breach of contract, not only actual and future monetary loss but also any other kind of negative consequences.<sup>70</sup> Thus, the monetary loss is a part of the broad concept of detriment that can be used in its interpretation. Detriment might extend to intangible or semi-intangible interests regardless of whether these appear in damages under Article 74 CISG; for example, losing specific or potential customers, losing resale possibilities, not being able to conduct one's business, losing

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<sup>65</sup> Honnold (n 52) para 183, 209.

<sup>66</sup> Schroeter (n 1) para 30, 413.

<sup>67</sup> *ibid* para 5, 402.

<sup>68</sup> Official Records, II, 330 as cited in Chengwei Liu, 'The Concept of Fundamental Breach: Perspectives from the CISG, UNIDROIT Principles and PECL and case law' (May 2005) para 2.2.a <<http://www.cisg.law.pace.edu/cisg/biblio/liu8.html>> accessed 17 June 2015.

<sup>69</sup> Will (n 5) 211.

<sup>70</sup> Ferrari (n 1) 495; Björklund (n 1) 338; Liu (n 62) at 8.2.2.1.

business reputation in the market, or any other benefit ultimately measured in financial terms.<sup>71</sup>

The doctrine agreed on the nature of detriment but disputes the degree of seriousness of the required detriment to allow avoidance.<sup>72</sup> There are several readings of the seriousness of detriment in Article 25 that have been submitted to represent what constitutes a substantial deprivation of contractual expectations: the common law look-alike test; monetary loss; quantitative test; frustrating the purpose of contract and continuous detriment; and depriving foreseeable contractual expectations.

#### **4.2.2.1 The common law look-alike test**

It has been submitted that although the draftsmen of the Convention did not intend to adopt any domestic concepts, the English doctrine of breach of fundamental term is now found in Article 25 of the Convention.<sup>73</sup> This fundamental breach of contract is not merely one which substantially impairs the value of the contract to the injured party but is a breach which ‘goes to the root’ of the contract. It is similar to the test applied in English law to determine whether or not an exemption clause survived particular breaches of contract.<sup>74</sup> One author suggests that both the distinction between conditions and warranties and the doctrine of intermediate terms are based on similar criteria to the fundamental breach concept of the Convention texts.<sup>75</sup> It has also been assumed that fundamental breach under the CISG is

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<sup>71</sup> Bridge (n 32) 918; Benjamin K Leisinger, *Fundamental Breach Considering Non-Conformity of the Goods* (Sellier 2007) 39.

<sup>72</sup> Will (n 5) para 2.1.2, 212.

<sup>73</sup> Ziegel (n 21) 9-14.

<sup>74</sup> *Diversitel Communications Inc v Glacier Bay, Inc* Supreme Court of Justice Ontario, Canada (6 October 2003) (holding that common law standard for ‘material breach’ is the same as the CISG’s ‘fundamental breach’ and then erroneously applying the common law); Ziegel (n 21) 9.

<sup>75</sup> Huber (n 36), 25.

similar to fundamental breach of an intermediate term of a contract under English law<sup>76</sup> and the provision of foreseeability in Article 25 CISG makes only literal but not substantive law in judging the seriousness of the breached obligation.<sup>77</sup>

However, the majority of CISG doctrines reject making parallels with fundamental breach in the CISG and ‘false friends’ that are found in certain common law jurisdictions.<sup>78</sup> The definition of fundamental breach was exclusively developed on the basis of the ULIS fundamental breach concept. Domestic law was not employed in drafting Article 25 CISG. In addition, breach of the English fundamental term gives rise to a right of termination but this is used in relation to the construction of exemption clauses whether or not disclaimer clauses survived a particular breach of contract.<sup>79</sup> The Convention does not employ the words ‘fundamental breach’ to deal with exclusion clauses.<sup>80</sup> In fact, the CISG approach with regard to contract avoidance appears to be far simpler than the one proposed by English law. The English law of termination of contract is not confined to the breach of a fundamental term and intermediate term which may or may not go to the root of the contract; rather, there is an extensive stock of express and implied conditions classified by the Sale of Goods Act (Sections 13 and following) any breach of which results in the right of termination. Furthermore, the fact that English fundamental breach is free of a foreseeability test, which is included in Article 25 CISG, leaves no room to defend the view that CISG avoidance and

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<sup>76</sup> Yan Li, ‘Remedies for breach of contract in the international sale of goods: a comparative study between the CISG, Chinese Law and English law with reference to Chinese cases’ (University of Southampton, School of Law, Doctoral Thesis) 20.

<sup>77</sup> Li (n 76) 23.

<sup>78</sup> Honnold (n 21) 204; Will (n 5) 209; Ferrari (n 1) 490 et seq.; Honnold (n 52) para 181.1; Schroeter (n 1) para 12, 405.

<sup>79</sup> Under English law, in certain development stage, the doctrine of breach of fundamental term was distinguished from the doctrine of fundamental breach. The former doctrine was used with regard to exemption clauses and has limited rule to play with termination of contract. The liability for breach of fundamental term could not be excluded by any exemption clauses. See GH Treitel, *Remedies for Breach of Contract: A Comparative Account*, (Clarendon Press 1988) para 267, 363ff.

<sup>80</sup> Honnold (n 52) 254.

English termination are based on the same criteria.<sup>81</sup> The only similarity is the fact that both consider it a matter of construction whether or not a breach entitles termination or avoidance of the contract. However, the mechanism of avoidance in each legal system differs widely.

#### **4.2.2.2 Monetary loss**

There is some debate among scholars as to whether the monetary loss suffered by the injured party may be taken as a test of fundamental breach. Some jurists have approached the fundamentality of the breach from the perspective of damages. This states that the extent of monetary loss suffered as a result of the non-performance to the overall value of the contract can be considered as a directly related factor in determining the expectations of the innocent party and fundamental breach.<sup>82</sup>

However, most authors take the view that damages are not the decisive factor. Rather, the aggrieved party's special interest in the performance of the particular obligation as fixed by the terms of the contract is the decisive factor in determining fundamental breach.<sup>83</sup>

#### **4.2.2.3 Quantitative test**

Some authors are uncertain whether or not a quantitative test can be used to determine fundamentality of breach. The comparison between Article 25 and its draft Article 23 suggests a quantitative as well as a qualitative meaning; otherwise, there would have been no point in changing the test of fundamental breach in the draft Convention. For example, if a seller delivers 10 per cent less of a quantity of goods than he had agreed to deliver there can be little doubt that the buyer has suffered a 'substantial detriment' under the meaning of Article 23 1978 draft Convention. However, in the same example, it cannot confidently be

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<sup>81</sup> Bridge (n 32) para 12.24, 567.

<sup>82</sup> Ulrich Magnus, 'UN-Kaufrecht' in Julius von Staudingers, *Kommentar zum Bürgerlichen Gesetzbuch mit Einführungsgesetz und Nebengesetzen* (13th edn, Sellier/de Gruyter 1995) cited in Koch (n 5) at note 114; Babiak (n 48) 120; Graffi (n 1) 340, 342, 344.

<sup>83</sup> Schlechtriem (n 28) 59; Koch (n 5) part V.

said that the buyer has been ‘substantially deprived’ of what he was entitled to expect under the contract under the meaning of Article 25 CISG. Setting proportional measures such as the suggestion that the buyer must have been deprived by fifty per cent or more of what he was entitled to receive before it can be said that there has been a ‘fundamental breach’ is not justified etymologically and would lead to startling results that could not have been intended by the delegates voting in support of the amendment to the draft Article 23.<sup>84</sup>

#### **4.2.2.4 Frustrating the purpose of the contract**

The breach of contract results in substantial detriment if the injured party has no further interest in the performance in case of such a breach. Detriment must be interpreted from a teleological perspective. This test is reminiscent of the test laid down in the former German law in section 286(2) and section 326(2) and in section 325(1) sentence 2 BGB.<sup>85</sup> This has been further developed by courts for other cases of breach of contract in order to justify termination (*von dem Vertrage zurückzutreten*) where, on account of the breach, the performance becomes of ‘no interest’ to the aggrieved party.<sup>86</sup> The very nature of detriment is not confined to an economic loss but encompasses every frustration to the purpose that the aggrieved party pursued with the contract.<sup>87</sup> The consequences of the breach can be a decisive factor but only in conjunction with the party’s special interest in the performance of the violated duty.<sup>88</sup> For example, neglecting to insure the goods during transport or not packaging them in a particular way, where the seller was obligated to do so by contract, constitutes a fundamental breach of contract if the lack of insurance or incorrect packaging deprives the buyer of the possibility of reselling the goods in transit even if the goods were

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<sup>84</sup> Ziegel (n 21) 9-16.

<sup>85</sup> *Bürgerliches Gesetzbuch* (German Civil Code) of 18 August 1896; for the termination of contract under these articles see: Treitel (n 79) para 263, 354ff.

<sup>86</sup> Schlechtriem (n 28) 59.

<sup>87</sup> Fritz Enderlein and Dietrich Maskow, *International Sales Law, United Nations Convention on Contracts for the International Sale of Goods: Convention on the Limitation Period in the International Sale of Goods* (Oceana 1992) 113.

<sup>88</sup> Schlechtriem (n 28) at note 210.

not damaged.<sup>89</sup> It is necessary that the party, as a consequence of the breach, has no interest in carrying out the contract.<sup>90</sup>

However, the test of frustrating the contract purpose is a very difficult one to satisfy. It is acceptable under former German civil law as an exceptional way to avoid the contract only because there is an alternative way widely available via *Nachfrist*.<sup>91</sup> Under the CISG and taking into account the central importance of the fundamental breach concept, it seems that such a higher threshold test for fundamental breach was not really intended in the various proposals and in the ultimate formula of fundamental breach in Article 25 CISG.

#### **4.2.2.5 Continuous detriment**

Some authors understand detriment not as a static element but, in many instances, as one that occurs only when the breach of contract continues and cannot be adequately compensated in damages.<sup>92</sup> The premise behind this view is that what matters most in commercial relations are economic results and not the formal fulfilment of obligations. Hence, when compensation for damages can serve as an adequate remedial action this should indicate that there is no detriment in the meaning of the Convention. However, there will be a detriment when the aggrieved party, in remaining bound to the contract, is hindered in his commercial or manufacturing activities in such a way that he can no longer be expected to continue to be held by it. In such cases, the detriment allows for avoiding the contract but it must be in existence at the time of the avoidance.<sup>93</sup>

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<sup>89</sup> Will (n 5) 211–12.

<sup>90</sup> Ziegel (n 21) 9-14; Koch (n 5) 267.

<sup>91</sup> The German BGB's new rules on the right to terminate a contract (*Rücktrittsrecht*) are based on similar concept of fundamental breach principle, although § 323(1) BGB primarily focuses on the setting of an additional period of time for performance before the contract can be terminated. See Schroeter (n 1) para 2, 400.

<sup>92</sup> Enderlein and Maskow (n 87) 113; Schwenger (n 63) 210.

<sup>93</sup> Enderlein and Maskow (n 87) 113.

In theory, upon fundamental breach of contract the aggrieved party will have an option to declare the contract avoided or elect another appropriate remedy. However, if the threshold test to declare avoidance is set too high because the availability of damages or any other remedy precludes avoidance then the question arises as to what are the residual situations under which the aggrieved party may elect between avoidance and choosing another remedy. Therefore, detriment must be interpreted with a less stringent approach in order to include cases where the aggrieved party may elect between avoidance and other remedies.

#### **4.2.2.6 Foreseeable contractual expectations**

This view gives the substantial deprivation of contractual expectations a different interpretation than the deprivation of substance of contract or frustrating the purpose of the contract. Fundamental breach is defined in the Convention to be deprivation of the legitimately expected interests of a contract.<sup>94</sup> There will be a fundamental breach if the aggrieved party has substantially deprived the legitimate interest of the other party under the contract.<sup>95</sup> The question, therefore, is what are legitimate interests? There is no abstract formula under which all facts can be neatly subsumed to infer an answer.<sup>96</sup> The difficulty here is largely embedded in the very concept of ‘what he is entitled to expect under the contract’ which ensures unpredictability in the availability of avoidance.<sup>97</sup> The fundamentality of the breach must be assessed in the light of the circumstances of each case<sup>98</sup> as it depends entirely on the injured party’s expectations as actually laid down and circumscribed by the individual terms of the particular contract in question and to the actual

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<sup>94</sup> Bruno Zeller, ‘Fundamental Breach and the CISG: a Unique Treatment or Failed Experiment’ (2004) 8 *Vindobona Journal of International Commercial Law and Arbitration* 81, 87.

<sup>95</sup> Schlechtriem (n 28) 59.

<sup>96</sup> Schroeter (n 1) para 8, 403.

<sup>97</sup> Michael G Bridge, ‘Avoidance for fundamental breach of contract under the UN Convention on the International Sale of Goods’ (2010) 59(4) *International and Comparative Law Quarterly* 911, 920.

<sup>98</sup> Björklund (n 1) 337; Joseph Lookofsky, ‘The 1980 United Nations Convention on Contracts for the International Sale of Goods’ in J Herbots and R Blanpain (eds), *International Encyclopaedia of Laws - Contracts*, Suppl 29 (Kluwer Law International 2000) 1, comment on article 25, 79.

breach which has occurred.<sup>99</sup> Breach of an ancillary obligation may deprive the injured party of his contractual expectations although it cannot be described as frustrating the purpose of the contract.

However, this view does not provide an alternative test; it simply confirms the conclusion that whether or not a breach was fundamental is a matter of judicial discretion within which particular factors may or may not play a prominent part.<sup>100</sup>

### **4.3 Foreseeability**

Foreseeability plays an important role in the interpretation by the parties of the importance of particular contractual terms. Not all contractual expectations are weighed in the balance in Article 25 CISG.<sup>101</sup> The detriment that results in fundamental breach must be interpreted objectively and must deprive the injured party of the interests to which he is entitled under the contract; it must not be based on the personal inner feelings or the subjective contractual expectations of the injured party. The relevant contractual expectations are only those legitimate interests that can be assessed through the provisions of the contract.<sup>102</sup> Therefore, it is primarily for the parties themselves to make clear what importance is to be attached to each obligation and to the corresponding interests of the promisee.<sup>103</sup> In many cases, these expectations are clearly established under the contract itself or clearly put beyond doubt during the contract negotiations so the party in breach cannot prevent avoidance of the contract by arguing that he did not foresee any detriment to the promisee. If an aggrieved party needs to avoid the contract then the detriment suffered by the party must be foreseeable

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<sup>99</sup> Schroeter (n 1) para 4, para 21; Björklund (n 1) 337; Lookofsky (n 98) 79.

<sup>100</sup> Bridge (n 97) 920.

<sup>101</sup> Enderlein and Maskow (n 87) 113-14.

<sup>102</sup> Alexander Lorenz, 'Fundamental Breach under the CISG' (June 1998)

<<http://www.cisg.law.pace.edu/cisg/biblio/lorenz.html>> accessed 8 June 2014; Will (n 5) 205.

<sup>103</sup> Schroeter (n 1) para 21, 409.



as being severe, otherwise there would be no fundamental breach.<sup>104</sup> However, foreseeability is not only detectable in the terms of contracts; some authors perceive it in the relationship between Article 8 CISG and Article 25 CISG because Article 25 CISG incorporates a modified version of Article 8 CISG.<sup>105</sup> If the contract language is ambiguous in defining the legitimate expectations, the rules on interpreting the parties' declared intentions by a reasonable man as the addressee, as set out in Article 8 (CISG), need to be consulted.<sup>106</sup> It is a question of interpreting the contract in accordance with Article 8(2) and (3) by asking what a party is entitled to expect under the contract<sup>107</sup> and whether the breaching party knew (or a reasonable person of the same kind in the same circumstances would have known) that, by entering into the contract, such expectations were especially important; for example, that the promisee would suffer a large loss if an ancillary obligation were breached or if there was a delay in delivery by a few days. What remains unknown and unforeseeable cannot be rightfully expected and, therefore, a breach that results in such a loss does not cause a fundamental breach of contract.<sup>108</sup> This may be illustrated by a few examples. In the sale of bespoke pine trees for Christmas and New Year the buyer is entitled to expect on-time delivery before the start of these festivals even though the contract is silent as to delivery time. The reasonable seller in such a contract would easily foresee that one week late in making delivery would deprive the buyer of re-sale opportunities. The buyer may rightfully avoid the contract if delivery is one week late. If the seller could not foresee such a result

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<sup>104</sup> Will (n 5) 209; Koch (n 5) 350.

<sup>105</sup> Article 8 CISG provides that: '(1) For the purposes of this Convention statements made by and other conduct of a party are to be interpreted according to his intent where the other party knew or could not have been unaware what that intent was. (2) If the preceding paragraph is not applicable, statements made by and other conduct of a party are to be interpreted according to the understanding that a reasonable person of the same kind as the other party would have had in the same circumstances. (3) In determining the intent of a party or the understanding a reasonable person would have had, due consideration is to be given to all relevant circumstances of the case including the negotiations, any practices which the parties have established between themselves, usages and any subsequent conduct of the parties' United Nations Convention on Contracts for International Sale of Goods (11 April 1980, entered into force 1 January 1988) 1489 UNTS 3; see also Zeller (n 94) 87.

<sup>106</sup> Zeller (n 94) 87.

<sup>107</sup> *ibid* 87.

<sup>108</sup> Schroeter (n 1) para 21, 409.

according to his own subjective view, he cannot insist that the buyer should take delivery and not avoid the contract because the foreseeability is based on the objective standard of a reasonable person.

It may also be the case that subjective and undisclosed contractual interests may not be taken into account. If the contract mentions that the containers of the goods should be of a specific material, such as wooden boxes, because it was important for the buyer to somehow re-use the wooden containers in his product, the seller should be informed of this fact. There can be no fundamental breach if the seller delivered the goods in plastic containers instead of the stipulated wooden containers because he was unaware of particular circumstances which the buyer had not informed him of.<sup>109</sup>

For this reason, it has been submitted that the foresight rule, over time, will be confined in practical terms to give idiosyncratic contracting parties an incentive to disclose their particular vulnerability. The further these expectations stray from the central disclosed interests, the more the requirement of foreseeability will play a part in setting limits on the availability of avoidance.<sup>110</sup> The subjective expectations of the aggrieved party may thus be subject to correction by an objective criterion. This correction protects the breaching party in a way that not every deprived expectation of the innocent party will justify avoidance.

#### **4.3.1 The reasonable person standard**

The rules in Article 25 and Article 8(2) and (3) CISG establish two types of interpretative criteria of a reasonable person:<sup>111</sup> the subjective test of intention that depends on the actual

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<sup>109</sup> Bridge (n 97) 920ff.

<sup>110</sup> *ibid* 920ff.

<sup>111</sup> Article 8 CISG (n 105) '(1) For the purposes of this Convention statements made by and other conduct of a party are to be interpreted according to his intent where the other party knew or could not have been unaware what that intent was. (2) If the preceding paragraph is not applicable, statements made by and other conduct of a party are to be interpreted according to the understanding that a reasonable person of the same kind as the other party would have had in the same circumstances. (3) In determining the intent of a party or the understanding a

intentions of the parties; and the objective test if the subjective test is not applicable.<sup>112</sup> The test of actual intent is not often applied in practice because it is not usually possible for a party to show either that the other party knew or that the other party could not have been unaware of the first party's intent.<sup>113</sup> The test in paragraph (2) of Article 8 CISG is an objective test that interprets a party's conduct according to the understanding that a reasonable person of the same kind as the other party would have had in the same circumstances.<sup>114</sup> It is similar in drafting to the test of foreseeability in that it takes into account the same interpretative criterion of the reasonable person and affirms the interpretative function of foreseeability in Article 25 CISG when evaluating the importance of the parties' interests in the performance of a certain obligation.

The objective test provides that the party in breach is considered to have been able to foresee the consequences of the breach if a reasonable person would have known about them. The criterion of a 'reasonable person' is followed by the sentence stating that his conduct should be assessed in conformity with the conduct of a person 'of the same kind ...' It is considered that these additional words make the reasonable person criterion more impartial since they are not given in an abstract way. In fact, they specifically relate to the conduct of a person engaged in the same branch of business or in the same trade. A judge should hypothesize a reasonable person of the same kind as the other party with respect to matters such as technical skills and linguistic background. A judge should have regard to the circumstances of the other party with respect to, for example, knowledge of prior dealings and negotiations between the

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reasonable person would have had, due consideration is to be given to all relevant circumstances of the case including the negotiations, any practices which the parties have established between themselves, usages and any subsequent conduct of the parties.'

<sup>112</sup> Bruno Zeller, 'Determining the Contractual Intent of Parties under the CISG and Common Law: A Comparative Analysis' (2002) 4(4) *European Journal of Law Reform* 629, 633.

<sup>113</sup> E Allan Farnsworth, 'Article 8' in Bianca and Bonell (n 5) 95, 99; United Nations Conference on Contracts for the International Sale of Goods UN Doc A/CONF.97/C.1/SR.12 (1981) at 295-301; Babiak (n 48) 121.

<sup>114</sup> Farnsworth (n 113) 99.

parties and awareness of world markets and events.<sup>115</sup> The importance of limiting the analysis to a specific trade sector must be stressed since reasonableness standards may considerably differ from one sector to another.<sup>116</sup>

Questions may arise over when the breaching party had special knowledge and thus could have foreseen more than this platonic reasonable person and whether the breaching party can be allowed to rely on the paradigm of the reasonable person to escape a finding of fundamental breach despite his special knowledge or foreseeability. One view is that the conjunction ‘and’<sup>117</sup> which replaced the former ‘or’ at the Vienna Working Group Session in 1977<sup>118</sup> makes it possible to conclude that such special knowledge cannot be taken into account in order to determine foreseeability. The party in breach must be understood to subjectively and objectively have foreseen the detriment as a result of his breach.<sup>119</sup> Foreseeability, therefore, will be an added protection for the breaching party against being guilty of fundamental breach.

However, such a view is untenable. A better interpretation according to the prevailing view is that the reasonable person test simply serves to eliminate unreasonable persons; the personal qualities of the party in breach are not essential for the foreseeability test.<sup>120</sup> The foreseeability may be gauged subjectively (foreseeability by the breaching party) or objectively (foreseeability by a reasonable person of the same kind). Therefore, the special knowledge must be taken into account because the objective defence of un-foreseeability cannot replace the subjective one but only complement it. This is the case because it may well happen that an overly astute merchant in fact knew and foresaw more than his peers

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<sup>115</sup> *ibid* 99.

<sup>116</sup> Graffi (n 1) 340.

<sup>117</sup> In the phrase: ‘and a reasonable person of the same kind in the same circumstances.’ Article 25 CISG (n 105).

<sup>118</sup> Summary Record, UN Doc A/CN.9(X)/C.1/SR.4 at 6, para 30 as referred to by Michida (n 5) 285 note 19.

<sup>119</sup> Koch (n 5) 265.

<sup>120</sup> Graffi (n 1) 340.

would have known and foreseen. In other words, the real person should not be allowed to hide behind the reasonable person of the same kind in the same circumstances. Thus, the burden of proof for the party in breach is a double one.<sup>121</sup> However, if the breaching party proved that he did not foresee and a reasonable person would not have foreseen the result then the burden of proof of the special knowledge would lie with the innocent party according to the prevailing view that the issue of the allocation of the burden of proof is an issue implicitly governed by the CISG in accordance with the Latin maxim *brocard onus probandi incumbit ei qui dicit*<sup>122</sup> (the burden of proof lies on the one who claims it).

#### **4.3.2 Reckless and intentional breach**

The Convention gives no precise answer to the question of whether a higher degree of fault, such as fraudulent conduct and intentional breach with foreseeability of the harmful results, would result in a fundamental breach or a wider right of avoidance for the aggrieved party. This question is too complex to be settled with an absolute rule but it is possible to argue in its favour. In fact, the Convention may house the suggested conclusion that a higher degree of fault and fraudulent conduct should be differentiated from an ‘innocent’ breach and thus result in a right of avoidance or substitute delivery. However, there are several arguments that can be presented to support this view.

The first argument is that the Convention, in several situations, deals with the breach that indicates fault by the breaching party more severely than an ‘innocent’ breach. Based on Articles 38 and 39 CISG, fraudulent conduct may limit the defences available to the breaching seller in cases of non-conformity. According to Article 40 CISG, the seller is not entitled to rely on the defences provided in Articles 38 and 39 CISG if the lack of conformity

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<sup>121</sup> Will (n 5) para 2.2.2.2.4, 220; in agreement Enderlein and Maskow (n 87) 116; Graffi (n 1) 341; Liu (n 68) para 2.3c.

<sup>122</sup> Graffi (n 1) 340.

relates to facts which he knew or could not have been unaware of and which he did not disclose to the buyer. Another example is that, pursuant to Article 66 CISG, the loss of or damage to the goods due to an act or omission of the seller discharges the buyer from his obligation to pay the price even though the risk was transferred to him at an earlier time. In other words, when there is a loss of or damage to the goods due to an act or omission of the seller the buyer has a right to reject the goods and elect to declare partial avoidance.<sup>123</sup> There is no obligation on the seller to offer substitute goods; similarly, the buyer is not obliged to accept the substitute goods if the seller has offered them. In this scenario, the buyer's right to avoid the contract is not based on the establishment of substantial deprivation of the contractual expectation but rather because there was a faulty act or omission by the seller.<sup>124</sup> Likewise, Article 72 CISG provides for the right to declare avoidance for anticipatory breach if it is clear that, prior to the date for performance of the contract, one of the parties will commit a fundamental breach of contract. The test in Article 72 CISG does not look to the seriousness of the current breach because the breach had not yet happened and the innocent party did not suffer actual deprivation of his contractual expectation. Article 72 CISG equates fundamental breach with the act of the breaching party and this destroys trust in future performance.<sup>125</sup>

The second argument is that the principle to observe good faith as laid down in Article 7(1) CISG expressly requires the parties to act in a proper way. If a party's breach is intentional or

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<sup>123</sup> The distinction between rejection and avoidance is unnecessary under the Convention because there are no rules for accepting the goods and revocation of acceptance as known in English Sale of Goods Act 1979 or as in UCC.

<sup>124</sup> A right to reject the goods may arise from any rule providing that the buyer may return the goods to the seller. Such a right exists especially if the contract is terminated (Articles 49, 51 (2), 72, 73) or if the buyer may require delivery of substitute goods (Article 46(2)). There may also be a right to reject under Article 52 (delivery before the date fixed or delivery of an excess quantity). It is also conceivable that a buyer may be entitled, under Article 71, to reject a partial delivery, because performance of the seller's other supply obligations has been rendered uncertain by the seller's deteriorating financial circumstances. Klaus Bacher, 'Article 85' in Ingeborg H Schwenger (ed), *Schlechtriem and Schwenger, Commentary on the UN Convention on the International Sale of Goods (CISG)* (3rd edn, Oxford University Press 2010) 1154, para 5, 1155.

<sup>125</sup> It is a similar situation in Article 7.3.1(2)(d) of the UNIDROIT Principles and Article 8:103(c) of the PECL (n 39).

reckless then the underlying relationship is irretrievably broken and the deal cannot be saved. Thus, the contract should only be saved if the parties have acted in good faith. This argument provides ground for avoidance for future performance of the contract, such as rejecting any further instalments.<sup>126</sup> Nevertheless, the good faith principle is vague and gives little guidance on how to deduce fundamental breach from intentional conduct.

The final argument is that the rules concerned with the interpretation of the CISG, gap-filling and the mandate to promote uniformity, as stated in Article 7(1) and (2), not only restrain the homeward trend in the application of the CISG but also instruct the court to consider the CISG's special character and its general principles and maximise the use of the other unification projects when matters are governed by the CISG but not expressly settled in it.<sup>127</sup>

Intentional and fraudulent breaches are closely related, with a provision in the CISG which states that it should be settled with the Convention's general principles; recourse to domestic law would take such an issue out of context. The question thus arises over how the intentional and fraudulent breach can be solved according to the CISG's general principles. Due to the fact that the Convention's general principles are not all expressly laid down therein, recourse to other unification projects, in particular, PICC as well as case law, may provide better relief. It seems that, according to Article 7(2) CISG, the courts may benefit from international case law and scholarly writings which have provided long lists of the Convention's general principles.<sup>128</sup> The UNIDROIT PICC consider intentional breach and reckless conduct to amount to fundamental non-performance.

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<sup>126</sup> Ferrari (n 1) 507; Koch (n 5) 224ff; Björklund (n 1) para 15, 338.

<sup>127</sup> If a matter is expressly excluded from the scope of CISG, Article 7(2) CISG (n 105), the Convention's general principles must not be referred to. The matters outside the scope of CISG application are enumerated in Article 4(2), Article 3(b), Article 5. See André Janssen and Sörren Claas Kiene, 'The CISG and Its General Principles' in André Janssen and Sörren Claas Kiene (eds), *CISG Methodology* (Sellier 2009) 261, para III.

<sup>128</sup> Janssen and Claas Kiene (n 127) para III.

It can be concluded from the above that the intentional and fraudulent breach by one of the parties may amount to a fundamental breach of some aspect of the Convention, such as the transfer of risk, partial avoidance, instalment contract and anticipatory avoidance. This means that more caution should be taken in dealing with cases that indicate intentional breach or fraudulent conduct by the breaching party. However, the conclusion that proving a higher degree of fault will have a particular effect on the availability of the avoidance right is not strongly supported by current CISG doctrine.<sup>129</sup>

### **4.3.3 Time of foreseeability**

The issue of determining the correct time at which the defaulting party should have foreseen the consequences of the breach is a very important issue that the CISG has not addressed.<sup>130</sup> Unlike the ULIS, the CISG does not clarify whether the relevant time should be when the contract was concluded<sup>131</sup> or when the breach was committed, or whether it should depend on the circumstances of each case. The answer to such a question might expand or abridge the rights that are based on fundamental breach of an obligation. It is inherently more likely that later information will expand the likelihood of substantial detriment than diminish it.<sup>132</sup> Due to the divergent understanding of Article 25 CISG, it is not surprising that the CISG's jurists reach different conclusions in answer to this question.

#### **4.3.3.1 The time of contract conclusion**

Some commentators have argued that foreseeability should always be determined at the time of contract formation.<sup>133</sup> Two main arguments have been submitted to support this view and

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<sup>129</sup> Schroeter (n 1) para 15, para 19; Magnus (n 35) 426; Schwenger (n 63) 207.

<sup>130</sup> Ziegel (n 21) 9-18.

<sup>131</sup> Article 10 of ULIS (n 4) specified the time of foreseeability, 'a breach of contract shall be regarded as fundamental wherever the party in breach knew, or ought to have known, at the time of the conclusion of the contract'.

<sup>132</sup> Bridge (n 97) 926.

<sup>133</sup> Koch (n 5) 265ff; Schroeter (n 1) 15; Schwenger (n 63) 209.



both try to balance the relationship between the foresight and the importance of the breached obligation. With reference to Article 74 of the Convention which limits damages to the foreseeable losses at the time of concluding the contract, one jurist found that the consequences that are unforeseeable at the time of contract formation are too remote to justify avoidance; nevertheless, they were foreseeable at the time of breach. In other words, extending the relevant time of foreseeability in Article 25 beyond the time of concluding the contract would justify avoidance on grounds that are regarded as too remote from the contractual expectations.<sup>134</sup> Other authors have added that, because the importance of contractual expectations must be determined only in the light of the circumstances known at the conclusion of the contract, it follows logically that the foreseeability of substantial deprivation of those expectations by the reason of breach should also be measured at that same time of contract conclusion.<sup>135</sup> Allowing for communications made after the conclusion of the contract to become relevant would permit a unilateral modification of the balance of the parties' interests as laid out in the contract, which is hardly appropriate.<sup>136</sup> A contract in which the delivery time is not essential cannot be turned into a time-of-essence transaction merely because the seller later learns that the buyer has obligated himself to sell the goods at a particular time.<sup>137</sup> However, this does not exclude the possibility of a modification of that balance by way of agreement between the parties.<sup>138</sup>

#### **4.3.3.2 The later time of concluding the contract**

Authors who want more protection for the aggrieved party disagree with this. Some of them afford too little protection to the party in breach by determining foreseeability at any time up

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<sup>134</sup> Ziegel (n 21) 9-20.

<sup>135</sup> Schwenzer (n 63) 210.

<sup>136</sup> Ferrari (n 1) 500.

<sup>137</sup> Schlechtriem (n 28) 60; Koch (n 5) 264ff.

<sup>138</sup> Ferrari (n 1) 500.

to the point of breach.<sup>139</sup> Others hold the time of the conclusion of the contract as a decisive point and permit consideration of subsequent knowledge only in exceptional cases, for example, in cases where preparations in view of performance have not yet started so that the other party can still adapt itself to the new situation. This is justified when the information available at the time of the conclusion of the contract did not reveal the required foresight of the consequences.<sup>140</sup> For instance, the subsequent knowledge of the seller that the agreed specific instructions on how to wrap the goods was essential for their resale in the envisaged sales area would have to be regarded as sufficient for the breach of the respective obligation to be characterized as fundamental.<sup>141</sup>

The latter view seems to be preferable to the historical point of view, and the general principle of good faith underlies the Convention provided that it does not incur additional costs. The drafting history of the CISG opposes determining the time of contract formation as the proper time when the foresight test should apply. The proposals to restrict foresight explicitly to a contract's concluding time were rejected within UNCITRAL<sup>142</sup> and at the Diplomatic Conference in Vienna.<sup>143</sup> It was not thought appropriate to specify the date of foresight explicitly in the Convention.<sup>144</sup> This omission indicates the legislative intention that foresight at any time prior to breach is relevant, at least in some cases. For example, it has

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<sup>139</sup> Shen (n 48) 13.

<sup>140</sup> '[T]he foreseeability principle presumably is designed to give [the breaching party] an opportunity to give special attention to minor details of performance the importance of which he could not otherwise have anticipated.' Honnold (n 52) 258.

<sup>141</sup> Enderlein and Maskow (n 87) 116; in agreement Will (n 5) para 2.2.2.2.5, 221; Babiak (n 48) 123ff.

<sup>142</sup> See Yearbook, VIII (1977), 31 No. 90, 1 1 No. 3, 148 No. 2, 148-149; Official Records, I, 26; United Kingdom (UN Doc A/CONF.97/C.1/L.104): Revised Article 23 to read as follows: 'A breach committed by one of the parties is fundamental if it results in substantial detriment to the other party unless at the time when the contract was concluded the party in breach did not foresee and had no reason to foresee such a result. A breach does not result in substantial detriment to the other party if damages would be an adequate remedy for him.'

<sup>143</sup> See the 12th Meeting of the First Committee (UN Doc A/CONF.97/C.1/SR.12) and 13th Meeting of the First Committee (UN Doc A/CONF.97/C.1/SR.13).

<sup>144</sup> 'The Commission, after deliberation, did not consider it necessary to specify at what moment the party in breach should have foreseen or had reason to foresee the consequences of the breach': Report of the Committee of the Whole on the 1977 Draft, Doc B(1), VIII Yearbook 25-64, A/32/17, Annex 1, para 90.

been argued that the time of foresight should be evaluated on a case-by-case basis<sup>145</sup> so that the knowledge of adverse circumstances, acquired by a party committing a wilful breach, should be relevant even though that knowledge was acquired after the contract date.<sup>146</sup>

Further support of the latter view is that extending foreseeability to the time of the breach should be based on the principle of good faith as stated in Article 7(1) CISG, at least to the extent that the party in breach was aware of that subsequent information.<sup>147</sup> Article 7(1) CISG provides that, in the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade. It would undermine the promotion of good faith to allow a party to escape liability of fundamental breach where the harmful result of his conduct was foreseeable.

This conclusion explains why, in some circumstances, the relevant time of the foreseeability test might be extended to the time of breach although the correct time to determine the legitimate contractual expectations is the time of concluding the contract. The innocent party is not entitled to avoid the contract if he has failed to inform the promisee of the essential importance of the breached obligation.

#### **4.4 Conclusion**

The concept of fundamental breach as defined in the CISG is a result of a rich history of legal debate. It finds its roots in the early efforts of harmonization of international sale of goods by the International Institute for the Unification of Private Law (UNIDROIT). At the drafting stage, the notion of the fundamental breach was initially linked to an individual obligation

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<sup>145</sup> United Nations, 'Commentary on the Draft Convention on Contracts for the International Sale of Goods prepared by the Secretariat' (Secretariat Commentary) UN Doc A/CONF.97/5, Article 23, para 4.

<sup>146</sup> See the 12th Meeting of the First Committee (UN Doc A/CONF.97/C.1/SR.12) and 13th Meeting of the First Committee (UN Doc A/CONF.97/C.1/SR.13); Honnold (n 52) 516-522; Bridge (n 97) 926.

<sup>147</sup> Graffi (n 1) 341.

and later to any contractual duty generally. A matter of significant dispute was whether fundamentality should be determined and proved subjectively by reference to what motivated the promisee to enter the contract or objectively by reference to the extent of the damage that had resulted from the breach. Another issue was the burden of proving fundamental breach. The solutions for proving fundamentality have formulated the current definition in Article 25 CISG which contains both subjective and objective criteria. There was no indication, at any stage of the discussions, that a definition would be adopted based on the economic feasibility of the avoidance of the contract or even to prevent avoidance when its consequences would result in a disproportionate loss caused to the breaching party compared to the benefit of the injured party. The adoption of the economic argument of favouring preservation of the contract in the definition of fundamental breach was not discussed by the drafters. The fundamental breach as a threshold of avoidance is objectively measured by reference to the subjective interests of the promisee that were known to the breaching party or that were actually laid down and demonstrated in the contract.

The definition of fundamental breach consists of two elements: substantial detriment and foreseeability. The substantiality refers to what the parties would have considered to be a substantial interest for performance had they applied their minds to it. The CISG's jurists have admitted that there is no exact test to ensure that such substantiality can be applied accurately in all cases. Article 25 CISG accommodated the sentiment that the judicial practice should play an important role in balancing the conflicting interests of the parties when determining the remedial action. Several tests have been submitted in interpretation of the fundamental breach. However, none of these interpretations has been universally accepted as a suitable test for all cases. The present view suggests that foreseeability plays an interpretative role in the contractual expectation. Therefore, the court may investigate the question of foreseeability without a request from a defendant. The time of foreseeability is

not restricted to the time of contract formation. There are special circumstances that may extend the time of foreseeability to a later time of contract formation.

## Chapter Five: Parties' definition of fundamental breach

Given the uncertainty associated with the definition of fundamental breach, it is highly desirable for the parties to agree in their contract on what breach should be considered fundamental in the sense of Article 25 CISG. The UNIDROIT Principles, in defining fundamental non-performance in terms of required strict compliance, encourages the parties to put in writing what they deem to be fundamental to the contract.<sup>1</sup> Despite the burden of negotiations, a well-drafted avoidance clause provides greater clarity about each party's rights and obligations. It also reduces the need for litigation as the party in breach will be able to assess the consequences of his breach and when he might fairly expect the other party to avoid. Similarly, the innocent party will be better informed on when to elect to affirm the contract or avoid it. A wrongfully declared avoidance may in its turn constitute a breach of contract and give rise to liability in damages. However, such an agreement for avoidance does not seem to happen very often in practice, at least not in those cases which have led to litigation.<sup>2</sup>

### 5.1 Contractual expectation within contractual terms

Article 6 allows parties to opt out of the Convention or any of its provisions.<sup>3</sup> It is generally accepted that the parties to a sale contract may provide their own definition and explanation for what is to be considered a fundamental breach in their contract. They may address

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<sup>1</sup> Article 7.3.1(2) UNIDROIT, *Principles of International Commercial Contracts* (3<sup>rd</sup> edn, 2010) (PICC): 'In determining whether a failure to perform an obligation amounts to a fundamental non-performance regard shall be had, in particular, to whether ... (b) strict compliance with the obligation which has not been performed is of essence under the contract.'

<sup>2</sup> Peter Huber, 'CISG: The Structure of Remedies' (January 2007) 71 *Rechts Zeitschrift für Ausländisches und Internationales Privatrecht* 13, 25.

<sup>3</sup> Article 6 United Nations Convention on Contracts for International Sale of Goods (11 April 1980, entered into force 1 January 1988) 1489 UNTS 3 (CISG/Vienna Convention/The Convention): 'The parties may exclude the application of this Convention or, subject to article 12, derogate from or vary the effect of any of its provisions.'; Bernard Audit, 'The Vienna Sales Convention and the Lex Mercatoria' in Thomas E Carbonneau (ed), *Lex Mercatoria and Arbitration* (Juris Publishing 1998) 173, 175; Michael Will, 'Article 25' in CM Bianca and MJ Bonell (eds), *Commentary on the International Sales Law* (Giuffrè 1987) 209.

specifically what each party is entitled to expect of the contract, which of its terms should be fundamental, the main purpose of the contract which if not achieved would confer on the other party a right of avoidance, the time of foreseeability, and the reasonable person standard. It is open to the parties to provide for special terms that override the default obligations set out under the Convention. The principle of party autonomy takes priority over other general principles where they would lead to a different result.

In the absence of a clear avoidance clause, it is indispensable first to analyse the parties' intentions in the light of contractual terms before resorting to the criteria that define fundamental breach in Article 25 CISG.<sup>4</sup> The questions of how to interpret the terms of the contract and what the intent of the parties was, in case of a dispute, are regulated by Articles 8 and 9 CISG. As a general rule, the interpretation of the declarations of the parties should be governed by the subjective intention of the declaring party but only insofar as this intention was recognizable or ought to be known to the other party. If the subjective intent cannot be ascertained, the objective intent is determined by the court according to the understanding of a reasonable person similarly situated.<sup>5</sup> Implied agreement, including the departure from Article 25 CISG or modification of its effects, may be evidenced from some circumstances of the case such as 'negotiations, any practices which the parties have established between themselves, usages and any subsequent conduct of the parties'.<sup>6</sup> If Article 8 fails to determine the terms of the parties' intention, a contract cannot be formed and application of CISG will

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<sup>4</sup> UG Schroeter, 'Article 25' in Ingeborg Schwenzer (ed), *Schlechtriem and Schwenzer, Commentary on the UN Convention on the International Sale of Goods (CISG)* (3rd edn, Oxford University Press 2010) para 9, 404.

<sup>5</sup> Martin Schmidt-Kessel, 'Article 8' in Ingeborg Schwenzer (ed), *Schlechtriem and Schwenzer, Commentary on the UN Convention on the International Sale of Goods (CISG)* (3<sup>rd</sup> edn, Oxford University Press 2010) 145, para 11, 151.

<sup>6</sup> Article 8(3) CISG (n 3); Larry A DiMatteo, 'An International Contract Law Formula: The Informality of International Business Transactions Plus the Internationalization of Contract Law Equals Unexpected Contract Liability' (Spring 1997) *Syracuse Journal of International Law and Commerce* 67.

be excluded.<sup>7</sup>

### **5.1.1 Negotiations**

CISG does not stipulate particular formalities or writing requirements to evidence the contractual terms so oral representations and prior negotiations may be used to overcome shortcomings in the clarity of the meaning of the written contract. For example, essentiality of strict compliance with the contract that renders any deviation from the contractual terms to be regarded as a fundamental breach may be proved through the negotiation stage.<sup>8</sup> If the buyer has notified the seller during the negotiation about the intended purpose for purchasing the goods, such as purchasing food for small children, but this purpose was not expressly stated in writing, such negotiations will be relevant to the interpretation of the agreement and should be given due consideration. In addition, the tribunal may consider evidence that the buyer proposed a certain contract purpose but that this proposal was rejected. If there was no evidence that the buyer's proposal was rejected, the circumstances should sufficiently show that the products had to be suitable for consumption by small children and that this feature was of primary importance.<sup>9</sup> If the delivered food was unsuitable for consumption by small children then the buyer would most likely be entitled to avoid the contract.<sup>10</sup>

### **5.1.2 Established prior dealings practices**

Contractual expectations can be established by reference to prior dealings adopted by the seller and the buyer. Pursuant to Article 9(1) CISG, the parties are bound by the 'practices

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<sup>7</sup> Article 4(a) CISG (n 3). 'This Convention ... except as otherwise expressly provided in this Convention ... is not concerned with: (a) the validity of the contract or of any of its provisions or of any usage ...'.

<sup>8</sup> Robert Koch, 'The Concept of Fundamental Breach of Contract under the United Nations Convention on Contracts for the International Sale of Goods (CISG)' (1999) Kluwer Law International, 177, 216.

<sup>9</sup> John Honnold, *Uniform Law for International Sales under the 1980 United Nations Convention* (3rd edn, Kluwer Law International 1999) 110; Benjamin K Leisinger, *Fundamental Breach Considering Non-Conformity of the Goods* (Sellier 2007) 44.

<sup>10</sup> Leisinger (n 9) 44.



which they have established between themselves'. Established courses of dealing are automatically applicable not only to supplement the terms of the contractual agreement but also, pursuant to Article 8, to help to determine the parties' intent except in cases where the parties expressly excluded its future application. In most cases, course of dealing will relate to a minor point, such as a certain tolerance for non-observance of statutory or contractual time requirements, for quantitative or qualitative defects of the delivered goods, for the granting of a price reduction or for notice procedures. However, course of dealing can sometimes affect the entire content of the contract. For example, if the parties in their previous transactions regularly adopted certain general conditions contained in a separate document then in subsequent contracts they may be bound by such conditions even in the absence of any express reference thereto.<sup>11</sup>

### **5.1.3 Trade usage**

A usage<sup>12</sup> of trade is any practice or method of dealing in international trade by parties to contracts of the type involved in the particular trade to which the parties belong.<sup>13</sup> The Convention derives effect to a usage on an objective basis from the general principles of party autonomy found in Article 6 CISG.<sup>14</sup> A usage that is contradictory to the CISG rules can, in that sense, be seen as an adaptation of the CISG as agreed between the parties.<sup>15</sup> A usage, of which the parties knew or ought to have known must have been 'widely known'

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<sup>11</sup> Michael Joachim Bonell, 'Article 9' in Bianca and Bonell (n 3) 106.

<sup>12</sup> For the role of usages in ULIS see: Heikki Jokela, 'The Role of Usages in the Uniform Law on International Sales' (1966) 10 Scandinavian Studies in Law 81.

<sup>13</sup> Bonell (n 11) 109.

<sup>14</sup> However, one view is that since it is the law itself which refers to usages as a possible means of interpreting contracts, their application in a particular case depends no longer on a corresponding intention of the parties but directly on the law; Bonell (n 11) 110.

<sup>15</sup> Patrick X Bout, 'Trade Usages: Article 9 of the Convention on Contracts for the International Sale of Goods' (Pace Essay Submission, 1998) para I <<http://www.cisg.law.pace.edu/cisg/biblio/bout.html>> accessed 16 February 2015.

and ‘regularly observed’ for a period of time.<sup>16</sup> Having such regularity of observance in a place or trade justifies the contractual expectations of the parties; thus, it is impliedly a part of the contract unless otherwise agreed. The decisive factor in applicability of usage, just as with any other contractual term, is the actual intent of the party invoking its application provided that the other party knew or could not have been unaware of that intent according to the understanding which a reasonable person of the same kind as the party would have had in the same circumstances.<sup>17</sup>

A usage must be distinguished from a custom or customary law which are fundamentally different from the trade usages to which Articles 8 and 9 CISG refer. Custom is a source of law that binds a party to a contract without regard to his intent.<sup>18</sup> In those settings, the question whether the tribunal may apply a particular usage by itself, in the same way as customary law, or upon request of the party claiming the relevance of that usage, is to be determined according to the law of procedure of the forum. However, the solution to such a question might differ if the disputes were submitted to arbitration rather than to a court. A brief survey of the major legal systems shows that almost all require that the party invoking a relevant usage must prove both its existence and its content; once the existence of the usage has been proved by the party, the judge decides as a question of law whether the usage is applicable to the particular contract. As far as arbitration is concerned, the rules of national and international legislation adopted by the various arbitration institutions or other organisations expressly allow or even require arbitrators to take into account relevant trade usages when making their decisions.<sup>19</sup>

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<sup>16</sup> Article 9(2) CISG (n 3).

<sup>17</sup> Article 8(2) CISG (n 3); Bonell (n 11) 107.

<sup>18</sup> Honnold (n 9) 147.

<sup>19</sup> see e.g., Article VII of the European Convention on International Commercial Arbitration (Geneva 21 April 1961); Article 1496 of the French Code of Civil Procedure as introduced by Decree no. 81-500 of 12 May 1981; Article 33 of the UNCITRAL Rules of Arbitration (as revised in 2010); Article 13 of the International Chamber

One view considers the issue of whether familiar and strict English treatment of terms in sales contracts as implied conditions could be imported as usages, further to parties' actual or presumed intention, into any contract governed by CISG with respect to the particular trades of a type that in former years would have been dealt with under English law.<sup>20</sup> It is questionable whether the implied conditions relating, for example, to time and documentary performance, would of themselves be recognized as implied exclusions of the Convention's avoidance regime based on the fundamental breach requirement. The CISG indicates that presumed intent is effective to derogate from any of the CISG provisions. However, it is important to note that the CISG does not follow the English division of contractual terms into conditions and warranties. In fact, English law recognizes implied conditions even when the parties have not attempted to exclude them in the contract; under the CISG, the avoidance question relates to whether the parties intended to exclude the CISG's provision of avoidance. This question must be answered not by distinguishing between the conditions of the contract and warranties but in the light of Article 8 CISG, according to the subjective or objective intent of the parties. Thus, implied exclusion of provisions in the CISG would require the parties to be less passive by, for example, inserting inconsistent express clauses in the contract. The Convention's efforts to become enshrined in international law and its primary aim of promoting uniformity would be diminished if the courts were to interpret a contract on the basis of a conditions/warranties classification.<sup>21</sup>

Usage may be international or local. What matters is not whether the usage is recognized at the place of contract formation but whether the relevant usage facilitates a conclusion

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of Commerce Rules on Conciliation and Arbitration; and Article 28(4) of the UNCITRAL Model Law on International Commercial Arbitration) cited in Bonell (n 11) 112; Jokela (n 12) para II G.

<sup>20</sup> JW Carter, 'Party Autonomy and Statutory Regulation: Sale of Goods' (1993) 6 *Journal of Contract Law* para 90; Michael Bridge, *The International Sale of Goods Law and Practice* (2<sup>nd</sup> edn, Oxford University Press 2007) para 12.24, 567.

<sup>21</sup> Carter (n 20) para 90 and 91; Bridge (n 20) para 12.24, 567; Bruno Zeller, 'Determining the Contractual Intent of Parties under the CISG and Common Law: A Comparative Analysis' (2002) 4(4) *European Journal of Law Reform* 629, 633.

regarding the intent of a party within the meaning of Article 8(1) CISG or whether it is a part of the objective interpretation within the meaning of Article 8(2) CISG. Therefore, a usage that is of local origin, such as the local practices for packing copra or jute, or the delivery dates imposed by the arctic climate, may be applicable if it is also recognized in the country of the addressee. However, if there are indications that the other party entertains a different meaning, the addressee cannot simply assume that the terms of the statement correspond to his usual understanding. In other words, local usages cannot be assumed to be a part of the expectations of the parties unless such effects were agreed.<sup>22</sup>

#### **5.1.4 Subsequent conduct of the parties**

Subsequent conduct allows the contract to be interpreted in the light of parties' behaviour over repeated occasions. Conduct of the parties subsequent to the conclusion of the contract may shed light on the original intentions of the parties and their expectations.<sup>23</sup> There are two particular situations that underline the importance of subsequent conduct. The first is where there is a doubt about the conclusion of the contract, such as in solving the discrepancies between offer and acceptance. In such a case, the conduct by both parties which recognizes the existence of a contract is sufficient to establish a contract for sale.<sup>24</sup> If one party accepts invoices which reference a contract from the other party then this indicates that the contract should be viewed as formed between them.<sup>25</sup>

The other situation is modification of the contract within the meaning of Article 29 CISG.<sup>26</sup> Conduct that indicates an agreement to increase or reduce the obligations of one of the parties

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<sup>22</sup> Honnold (n 9) 148.

<sup>23</sup> *ibid* 143.

<sup>24</sup> *ibid* 143.

<sup>25</sup> *Floor Tiles Case* Appellate Court Stuttgart, Germany (28 February 2000); Schmidt-Kessel (n 5) 172.

<sup>26</sup> Schmidt-Kessel (n 5) 172.

needs to meet no further requirements to be binding.<sup>27</sup> Moreover, a party may be precluded by his conduct from asserting a certain provision to the extent that the other party has relied on that conduct;<sup>28</sup> the one-sided subsequent modification of the contract brought about by corresponding conduct must be prevented.<sup>29</sup> For example, acceptance of a late delivery or acceptance of a time period for performance under Article 48(2) CISG contradicts the assertion that time was of the essence.<sup>30</sup> A buyer who requests the invoice for the entire delivery without reservation, knowing that only a portion of the goods would be used, conflicts with an agreed-upon right of return.<sup>31</sup> Likewise, a party's continuing performance of the contract is contrary to his belief that he had effectively declared the contract avoided.<sup>32</sup> This notion is, however, not without difficulties since accepting a different practice from that provided under the Convention or the contract does not necessarily indicate a special agreement; it may only represent generosity on the part of the obligee. The basis of these considerations is the declaratory value of acceptance without objection. For instance, acceptance of performance in order to mitigate the loss within the meaning of Article 77 CISG should not prejudice the aggrieved party's right to damages although it can indicate that the breach of contract was not a fundamental one.<sup>33</sup>

The subsequent conduct of the parties permits the court to conclude an agreement of the parties to avoid the contract. In the *Used Printing Press* case the court found that the parties had mutually terminated the contract. The buyer had refused to accept delivery with regard to three missing machines and the seller had only expressed regret at the buyer's refusal. A reasonable person, as set out in Article 8 CISG, could have understood the seller's letter as an

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<sup>27</sup> Article 29(1) CISG (n 3), such an agreement may be ineffective in common law unless an act or promise is given in exchange as a consideration.

<sup>28</sup> Article 29(2) CISG (n 3).

<sup>29</sup> Schmidt-Kessel (n 5) 172.

<sup>30</sup> *Shoes Case* Lower Court Nordhorn, Germany (14 June 1994); Schmidt-Kessel (n 5) 173.

<sup>31</sup> *CV BV v W* Bezirksgericht St. Gallen, Präsidium (3 July 1997); Schmidt-Kessel (n 5) 172.

<sup>32</sup> *Acrylic Blankets Case* Appellate Court Koblenz, Germany (31 January 1997); Schmidt-Kessel (n 5) 172.

<sup>33</sup> *Circuit Boards Case* Appellate Court Hamburg, Germany (5 October 1998); Schmidt-Kessel (n 5) 173.

acceptance of the termination of the contract.<sup>34</sup>

### **5.1.5 Conclusion**

The court has ample tools to interpret the contract and to assess the fundamentality of the breach according to the parties' expressed or implied intention. These tools are based on the understanding that a reasonable person would have of the declaratory will behind contractual terms. The court may also conclude an agreement to avoid the contract according to the interpretation of the subsequent conduct of the parties.

## **5.2 Contractual expectation within conflicting standard terms and conditions**

Standard form contracts are those contracts with pre-printed general terms and conditions. In commercial international sales practices during the contract formation, parties communicate through printed forms that incorporate standard terms of business (standard terms and conditions, standard forms, general conditions, conditions of sale or purchase). Such a practice has led to what has come to be called the 'battle of the forms' problem where both parties refer to their own standard forms and declare that the contract is exclusively governed by these conditions and that no other conditions are accepted.<sup>35</sup> Since each party's form contains provisions that favour their respective positions they hardly ever match each other.<sup>36</sup> The standard forms generally conflict on indemnity and liability, risk of loss, payment term and payment of interest, warranties, remedies, applicable laws and arbitration.<sup>37</sup> For example, the buyer's form may contain express warranties while the seller's may include a disclaimer

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<sup>34</sup> *Used Printing Press Case* Appellate Court Celle, Germany (24 May 1995); Schmidt-Kessel (n 5) 172.

<sup>35</sup> Ulrich Magnus, 'Last Shot vs. Knock Out: Still Battle over the Battle of Forms Under the CISG' in Ross Cranston, Jan Ramberg and Jacob Ziegel (eds), *Commercial Law Challenges in the 21st Century; Jan Hellner in Memoriam* (Stockholm Centre for Commercial Law Juridiska Institutionen 2007) 185, 186.

<sup>36</sup> UG Schroeter, 'Article 19' in *Schlechtriem and Schwenzler* (n 4) 334, para 31, 347.

<sup>37</sup> Nguyen Trung Nam, 'Future of Harmonisation and Unification in Contract Law Regarding Battle of Forms' (September 2009) chapter I.I.1 <<http://www.cisg.law.pace.edu/cisg/biblio/nam.html>> accessed 3 September 2014.

of warranties. Usually, most of these contracts are carried out without incident if the parties agree on the commercial essentials of the contract, such as price, place and time of payment, kind, quality and quantity of the goods, place and time of their delivery.<sup>38</sup> The parties are unlikely to pay any attention to the fact of conflicting legal forms when they make a deal; it is only when a dispute arises that it is discovered that each party has sent his standard form contract to the other and that there are differences between them.<sup>39</sup> It is likely that each party will seize upon his own standard terms, qualifying them as an indispensable part of his consent and expressly denying any effect to the deviating terms of the other party.<sup>40</sup>

A number of legal questions arise in such a dispute. Do discrepancies in standard forms result in a contract? If so, what are its terms? To what extent do these standard forms truly represent the contractual expectations of the parties? To what extent can one party effectively increase the importance of a certain obligation through his standard business terms in order to make it a 'fundamental' contractual interest for the purposes of Article 25 CISG? Can standard terms exclude a party's right to avoid the contract in situations in which the other party had committed a fundamental breach of contract as per Article 25?

### **5.2.1 Do discrepancies in standard forms result in a contract? If so, what are its terms?**

As a rule, under Article 19(1) CISG a contract is only concluded upon complete agreement between offer and acceptance.<sup>41</sup> Any deviation from the contents of the offer makes an acceptance turn into a rejection and a counter-offer, thus raising questions of life or death for the contract.<sup>42</sup> However, for practical reasons, Article 19(2) permits the offeree, who last

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<sup>38</sup> Magnus (n 35) 187.

<sup>39</sup> Larry A DiMatteo and others, *International Sales Law: A Critical Analysis of CISG Jurisprudence* (Cambridge 2005) 66.

<sup>40</sup> Schroeter (n 36) para 31, 347.

<sup>41</sup> Article 19(1) CISG (n 3) clearly opposes the idea of the principle of *favor contractus* being recognised at the stage of contract formation under CISG.

<sup>42</sup> Schroeter (n 36) para 34, 348.

referred to its terms, to reply with immaterial deviation from the offer unless the offeror promptly objects orally or in writing about the discrepancy. Accordingly, if the seller replies affirmatively to the buyer's offer to buy the goods but refers to or sends over a standard form contract, the buyer who does not like the seller's term or who has changed his mind may refuse, without undue delay, to enter into the contract.<sup>43</sup> Otherwise, his consent is irrefutably presumed if the deviation was immaterial.<sup>44</sup> The line between material and immaterial deviations as drawn by Article 19 causes difficulties which may be hard for the parties to observe and can scarcely be justified.<sup>45</sup> An exemplary but a non-exclusive provision is used to distinguish between material and immaterial deviation. Article 19(3) CISG declares almost any kind of deviation as material. The deviations of the terms of the price, payment, quality and quantity of the goods, place and time of delivery, and extent of one party's liability to the other or the settlement of disputes are material and seem to prevent the contract formation. In most cases, the few terms not mentioned, for example, penalty clauses and clauses concerning securities or concerning rights of withdrawal will also qualify as material modifications.<sup>46</sup>

It seems that, due to Article 19(1) CISG, the offeror who received a reply that purports to be an acceptance but which contains a reference to a standard form that materially changed the offer has no duty to react; if he does not react, no contract exists because mere silence or inactivity is not sufficient to be acceptance of the counter-offer.<sup>47</sup>

Turning to the first question of whether the discrepancies between standard forms hinder the formation of the contract at all, the prevailing view seems to be that Article 19(1) CISG

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<sup>43</sup> Jan Hellner, 'The Vienna Convention and Standard Form Contracts' in Petar Sarcevic and Paul Volken (eds), *International Sale of Goods: Dubrovnik Lectures* (Oceana 1986) chapter 10, 335, 340.

<sup>44</sup> Magnus (n 35) 189.

<sup>45</sup> Hellner (n 43) 342.

<sup>46</sup> Magnus (n 35) 190.

<sup>47</sup> Article 18, para 1 sentence 2 CISG (n 3); Magnus (n 35) 189.



applies not only to individual terms but also to terms contained in standard form contracts before performance has begun. However, if the contract is performed there will be no practical possibility of maintaining that no contract exists. After performance, Article 19 CISG is not well suited to the ‘battle of forms’, the terms of which are numerous and varied, and these should not be judged at all by the mirror image rules on offers and counter-offers.<sup>48</sup> This view is reinforced by the fact that the Convention does not lay down particular requirements for the incorporation of standard terms into a contract. At the Vienna Conference in 1980, the Belgian delegation proposed that the Convention should include a rule on the ‘battle of forms’ but this proposal was rejected.<sup>49</sup>

Another way out of Article 19 CISG is to retreat the basic principle of party autonomy as given in Article 6 CISG. The parties must remain free to reject an offer and answer with a counter-offer. However, mere use of conflicting general terms is no clear indication that an offer as such is rejected, with the risk that no contract comes into existence. If the parties have agreed on the essential terms of the contract and have performed despite contradictions in their standard terms, there would be an implied derogation from Article 19 CISG.<sup>50</sup> What the terms of the resulting contract are or how the battle of forms should be decided would probably be determined by a realistic estimation of the parties’ common intent in accordance with Article 14 et seq and in conjunction with Article 8 CISG.<sup>51</sup> There are two main theories in order to determine which standard form prevails: the last shot rule and the knock out rule.<sup>52</sup> The last shot rule decides the battle according to a literal and strict application of Article 19

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<sup>48</sup> Hellner (n 43) 343.

<sup>49</sup> *ibid* 343.

<sup>50</sup> Magnus (n 35) 192.

<sup>51</sup> This approach has been adopted by the majority of commentators and international courts, including courts from Austria, Germany, Italy, the Netherlands, Switzerland, and the US. See *Schlechtriem and Schwenger* (n 4) para 33, 275.

<sup>52</sup> Magnus (n 35) 188ff.

CISG; therefore, a form fired last constitutes the basis of the contract.<sup>53</sup> Recent court practice tends towards the knock out rule which accepts the agreement of the parties on the essential terms, leaves the non-conflicting standard terms of both sides as part of the contract intact and substitutes the conflicting terms with the respective provisions of the Convention or any other applicable law.<sup>54</sup> However, in the past, recourse to domestic law has only been followed by a small minority of courts and is unlikely to gain additional support in the future.<sup>55</sup>

### **5.2.2 Contractual expectations within standard terms**

It is questionable whether contractual expectations of the parties can effectively be expressed via standard terms. Where the conflicting standard forms are part of the parties' declaration of offer and acceptance it is necessary to evaluate, at first, whether the parties have clearly insisted on enforcing their own standard terms at the expense of the transaction being concluded. It would be more prudent for the party who does not wish to conclude a contract unless his own standard terms are accepted to be less passive and declare such an intention unequivocally to the other party in some way, other than by general contract terms.<sup>56</sup>

In the absence of such intention, commercial reality indicates that the differences between standard forms do not affect parties' mutual consent to their contract. The parties are generally very well aware of the fact that their respective standard forms do not conform in every respect but differ in some way. Standard terms are rarely taken seriously at the time of conclusion of the contractual relationship. The parties consider their standard forms and the reference made to them to be less important than the conclusion of the contract. The parties are not, in fact, interested in the differences in their standard terms when they negotiate and conclude their contract. Standard terms are brought in as purely precautionary tools and as

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<sup>53</sup> *ibid* 191.

<sup>54</sup> *ibid* 193.

<sup>55</sup> UG Schroeter, 'Article 14' in *Schlechtriem and Schwenzler* (n 4) 257, para 33, 275.

<sup>56</sup> Magnus (n 35).

defensive incorporation clauses when something goes wrong with the contract. They are fundamentally based on the assumption that a valid contract has been concluded. The root cause of the battle of forms is a misunderstanding, not between the merchants involved but between the merchants and their lawyers. On the one hand, merchants come to terms with each other and wish to structure their transactions more efficiently by instructing their lawyers to draft a set of standard terms suitable for them; on the other hand, in order to protect their rights and limit their legal liabilities and risks, lawyers from both sides try to ensure that their own standard terms are applied to the transaction, normally by including ‘only under the following terms & conditions’ with the general terms and conditions attached in their communication.<sup>57</sup> In this sense, standard forms are second class contract terms which enter the battle field only when a dispute between the parties has started. At least in the eyes of the parties, the standard terms do not have the same weight as the commercial essentials terms, such as price and quantity which are indispensable for the existence of the contract.<sup>58</sup>

### **5.2.3 Can standard terms exclude a party’s right to avoidance?**

This question presupposes that one party is entitled to declare the contract avoided upon fundamental breach of the other party or *Nachfrist*. However, according to the standard terms of the breaching party the innocent party is only entitled to claim damages but not to avoid the contract.

This question is not governed by a particular article but by the general principles of the Convention. The most relevant principles are the principles of party autonomy and the duty of good faith and fair dealing. The parties may accept or exclude certain remedies that are otherwise normally available in case of breach of contract. If the parties agree on the clause that the seller will not be responsible for the quality of the goods, the buyer may not be

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<sup>57</sup> Trung Nam (n 37) chapter I. I.1

<sup>58</sup> Magnus (n 35); Schroeter (n 4) para 41, 352.

allowed to avoid the contract if the non-conformity was a fundamental breach. However, the effectiveness of such a clause will be subject to the good faith principle. In addition, the validity of such clauses will be subject to the domestic law as determined by private international law.

It is unlikely that non-performance of standard terms would result in fundamental breach of contract. The standard terms do not reflect the real interest of the parties but they provide solutions on precautionary bases. In addition, standard terms cannot serve as exemption clauses unless this was clearly stipulated as part of the offer or acceptance.

### **5.3 Conclusion**

The threshold of fundamental breach recognizes the parties' will at the time of contract conclusion and what they considered as fundamental to their bargain. If there is a dispute as to interpretation of the contract then the communication between the parties should be understood by a reasonable person of the same kind as the addressee. Therefore, complete disclosure of a proposed relationship between buyer and seller is desirable in order to ensure that a contractual relationship stays relatively non-litigious. The courts have discretion in each litigated case to understand the substantial detriment in the light of the contractual terms and the wording of the disputed contract as they reflect the parties' will in that specific case. The question, therefore, is how the definition of fundamental breach has been applied under courts' discretion and whether is it possible to conclude from courts' discretion which breach ought to be fundamental. These questions will be the subject of the next two chapters.

## Chapter Six: Fundamental breach for non-performance and late performance

In theory, it is immaterial whether the party in breach is the buyer or the seller in qualifying a breach as fundamental because the test of fundamentality does not distinguish whether the non-performing party is a buyer or a seller; the same rule of Article 25 CISG is applicable to both. In addition, the structure of remedies in the CISG is independent from the importance of the obligation in question. Any breach of duty represents a failure to perform and, in principle, triggers the remedies enumerated in Articles 45(1) and/or 61(1). Arguably, the various classifications of contractual obligations such as obligation to perform and to achieve, or primary obligation and secondary obligation have no particular importance in identifying fundamental breach.<sup>1</sup> All types of contractual obligations may be relevant for the determination of the essential contractual interest regardless of whether they are principal or ancillary obligations.<sup>2</sup> However, this does not mean that the various types of failures in performance can entirely be ignored under the CISG's system of remedies because the interests of the parties might not be of the same importance for each single obligation. It has been suggested that a fragmented approach to studying fundamental breach in the CISG's case law may help to find guidance for the application of this concept.<sup>3</sup>

For the sake of clarity, fundamental breach would be better evaluated according to the type of breached obligation in the light of essential contractual expectations. This approach more easily allows the identification of certain types of cases that strongly suggest the existence of a fundamental breach of contract.<sup>4</sup> Therefore, the question of whether a party has a right to avoid the contract will be approached by considering three broad types of breach: non-

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<sup>1</sup> Benjamin K Leisinger, *Fundamental Breach Considering Non-Conformity of the Goods* (Sellier 2007) 5.

<sup>2</sup> *Cobalt Sulphate Case* Supreme Court Germany (3 April 1996); *Tannery Machines Case* Appellate Court Köln, Germany (8 January 1997).

<sup>3</sup> Leonardo Graffi, 'Case Law on the Concept of "Fundamental Breach" in the Vienna Sales Convention' (2003) 3 *International Business Law Journal* 338, 345.

<sup>4</sup> Franco Ferrari, 'Fundamental Breach of Contract under the UN Sales Convention: 25 Years of Article 25 CISG' (Spring 2006) 25 *Journal of Law and Commerce* 489, 496ff; Graffi (n 3) 345.

performance, late performance and defective performance. A discussion on non-performance breaches of the seller and the buyer will be conducted in this chapter while the breach for non-conformity will be discussed in the next chapter.

## **6.1 Common rules on breach by the buyer or the seller**

The obligations of the seller or the buyer in international sale contracts that are enumerated in the CISG only have a complementary function.<sup>5</sup> The private regulations of the parties as to their obligations, whether they are in the form of an express agreement or by interpretation of the contract in the light of practices and usages pre-empt the Convention's rules, which apply only in the absence of such agreement.<sup>6</sup>

### **6.1.1 Obligations of the seller**

According to the Convention, the seller is bound to deliver the goods, to hand over the documents concerning them and to transfer the property in the goods.<sup>7</sup> The seller has to deliver conforming goods and the goods should not be subject to third party rights. Unlike the ULIS, delivery in the CISG is not defined by reference to the conformity of the goods to the contract. Article 19(1) ULIS prescribed that delivery consisted of the handing over of goods which conformed to the contract, in other words, it was a case of non-delivery if the goods delivered lacked conformity.<sup>8</sup> In contrast, the intention of the CISG drafters was to treat the two issues (delivery and conformity) separately. Articles 31 to 34 CISG describe the acts that

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<sup>5</sup> Fritz Enderlein, 'Rights and Obligations of the Seller under the UN Convention on Contracts for the International Sale of Goods' in Petar Sarcevic and Paul Volken (eds), *International Sale of Goods: Dubrovnik Lectures* (Oceana 1996) chapter 5, 133, 137.

<sup>6</sup> John Honnold, *Uniform Law for International Sales under the 1980 United Nations Convention* (3rd edn, Kluwer 1999) § 207, 238; Ole Lando, 'Place of Delivery: Article 31' in CM Bianca and MJ Bonnell (eds), *Commentary on the International Sales Law* (Giuffrè 1987) 251.

<sup>7</sup> Article 30 CISG (United Nations Convention on Contracts for International Sale of Goods (11 April 1980, entered into force 1 January 1988) 1489 UNTS 3): 'The seller must deliver the goods, hand over any documents relating to them and transfer the property in the goods, as required by the contract and this Convention.'

<sup>8</sup> For further consequences of this concept see: Ole Lando, 'Obligations of the Seller: Article 30' in Bianca and Bonnell (n 6) 245ff.

constitute the seller's obligation to deliver the goods, and the time and place for delivering the goods; while the quality of the goods and their freedom from third party claims is dealt with in Articles 35 to 44 CISG.

### **6.1.2 Obligations of the buyer**

The main obligations of the buyer, as succinctly summarized in Article 53 CISG, are to pay the price for the goods and to take delivery of them as required by the contract and this Convention. The Convention gives further details for different acts that are typical of sales transactions which could be seen as the subject-matter of different obligations made to perform these two obligations. The obligations mentioned in Article 53 and following are primary obligations which are to be fulfilled in the normal performance of the contract but the parties' contract plays a role at least as important as that of the Convention in defining the exact scope of these main duties of the buyer. Virtually all international sales of goods contracts pay particular attention to the choice of trade terms and to the conditions of payment. Frequent reference is made to the appropriate commercial terms, such as the rules of the International Chamber of Commerce (INCOTERMS, Uniform Rules for Collections, Publications no. 322 of the International Chamber of Commerce, Uniform Customs and Practice for Documentary Credits, Publications no. 600 of the International Chamber of Commerce) so that the obligations of the buyer pursuant to these instruments become part of his obligations according to Articles 53 to 60 CISG.

### **6.1.3 Non-performance due to an impediment**

A party's failure to perform his obligations due to an impediment may be considered a fundamental breach. The impact of an impediment is to exempt the debtor from his obligation to pay damages. If the seller was unable to deliver the goods, the buyer is entitled to use all other remedies, including the right to declare avoidance and claim restitution of his own

performance but he will not be entitled to claim damages. The Convention is silent on whether the party that faces impediment has the right to avoid the contract or whether the declaration of avoidance is still needed if it became impossible to perform the agreed obligations. Such a question seems to be one of logic rather than one of law. When performance becomes impossible due to an impediment beyond the control of either of the contracted parties, the discharge of obligation occurs from the date of impediment and any party that has an interest in such a discharge may declare avoidance.

#### **6.1.4 Non-performance due to act or omission of the obligee**

A party's failure to perform his obligation would not be considered a fundamental breach if it was due to the act or omission by the obligee, such as the buyer's failure to supply the agreed drawings or part of the materials that is necessary to enable the seller to perform his obligation.<sup>9</sup> The seller may fail to deliver the goods or the documents because of the buyer's failure to fulfil his relevant obligation, such as payment of the price or undertaking the export or import formalities. Whether the seller is in breach of non-delivery in these examples depends on which party is responsible for fulfilling these requirements, for example, to obtain the necessary export or import licences. The buyer must perform his obligations in order to enable the seller to perform his part of the transaction, such as the obligation to determine the shape and measures of the goods or other characteristics. The buyer may incur other obligations that are typical of sales transactions, such as to provide security interests, furnish information, plans and technical drawings, deliver materials or components, follow

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<sup>9</sup> Fritz Enderlein and Dietrich Maskow, *International Sales Law, United Nations Convention on Contracts for the International Sale of Goods: Convention on the Limitation Period in the International Sale of Goods* (Oceana 1992) 115; Anna Kazimierska, 'The Remedy of Avoidance under the Vienna Convention on the International Sale of Goods' [1999-2000] *Pace Review of the Convention on Contracts for the International Sale of Goods* 138.



distribution directives, and heed export and re-import prohibitions.<sup>10</sup> Furthermore, the seller may have a right to withhold performance according to lien or other legal grounds. If none of the above circumstances are applicable, definite non-delivery is qualified as a fundamental breach of contract.<sup>11</sup>

### **6.1.5 Non-performance of ancillary obligation**

The CISG does not distinguish between the breach of ancillary and principal obligations. All types of contractual obligations may be relevant for the determination of the essential contractual interest regardless of whether they are principal or ancillary obligations. The breach of an ancillary obligation, such as a re-import prohibition, exclusivity agreement and the type of transportation in sales which involve carriage of goods, is fundamental as long as the parties have intended it to have such effect. The seller may avoid further contractual performances in the event that the buyer fails to disclose the ultimate destination of the goods. In *BRI Production 'Bonaventure' v Pan African Export*,<sup>12</sup> the French seller was insistent on knowing where the goods, the 'Bonaventure' jeans, were sent. The US buyer specified that the jeans were to be sold in South America and Africa. During the second delivery, however, it became apparent that the jeans had been shipped to Spain in breach of a prohibiting distribution clause on selling the jeans in Spain. The sale of the seller's products in Spain was seriously hampered by the parallel distribution made by the final customer of the buyer. The court considered the buyer's breach as fundamental and held that the seller

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<sup>10</sup> Peter Schlechtriem, *Uniform Sales Law: The UN-Convention on Contracts for the International Sale of Goods* (Manz 1986) 80.

<sup>11</sup> Nina Freiburg, *Das Recht auf Vertragsaufhebung im UN-Kaufrecht: Unter besonderer Berücksichtigung der Ausschlußgründe* (Duncker and Humblot 2001) 59; UG Schroeter, 'Article 25' in Ingeborg Schwenzer (ed), *Slechtriem and Schwenzer, Commentary on the UN Convention on the International Sale of Goods (CISG)* (3rd edn, Oxford University Press 2010) 405.

<sup>12</sup> *BRI Production 'Bonaventure' v Pan African Export* Appellate Court Grenoble, France (22 February 1995); see also Larry A DiMatteo and others, 'The Interpretive Turn in International Sales Law: An Analysis of Fifteen Years of CISG Jurisprudence' (Winter 2004) 34 *Northwestern Journal of International Law and Business* 299, 383.

could declare the contract avoided according to Article 64(1), invoking in addition Article 73(2) with regard to the contracts for further deliveries. The French court invoked Article 8(1) CISG in order to conclude that the buyer had not respected the wish of the seller to know the destination of the goods. The buyer's failure to keep his promise about the distribution area constituted a fundamental breach of contract within the meaning of Article 25 CISG although the buyer could not foresee where his sub-buyer would sell the goods.

However, in a similar case delivered by the District Court of Frankfurt that involved the breach of an exclusivity term, the buyer was left without a remedy. In this case,<sup>13</sup> a German buyer ordered 120 pairs of shoes from an Italian seller through a commercial agent in accordance with the seller's standard form. The standard form contained a clause granting the buyer exclusive rights to distribute the goods within a specific district, 'Esclusiva su B'. Once the shoes were delivered, the seller requested that the buyer pay within 60 days of delivery. The buyer, after selling 20 pairs of the shoes, discovered that the seller had sold identical shoes to another German company in another district that had distributed the shoes at a lower price through its branch in the first buyer's district. Apparently, the seller had not intentionally violated the contractual exclusivity term because a commercial agent organized the sale to the second buyer. The agent either intentionally violated the exclusivity term or was unaware that the second buyer had a secondary place of business in the area reserved for the first buyer.<sup>14</sup> Because the first buyer did not receive exclusive deliveries as promised, he declared the contract avoided under CISG Article 49(1)(a); he sent the remaining 100 pairs of shoes back to the seller, cancelling his order and promising payment for the 20 shoes. The

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<sup>13</sup> *Shoes Case* District Court Frankfurt, Germany (16 September 1991); see also Robert Koch, 'The Concept of Fundamental Breach of Contract, Review of the Convention on Contracts for the International Sale of Goods (CISG) 1998' (1999) *Kluwer Law International* 177, 248; Martin Karollus, 'Judicial Interpretation and Application of the CISG in Germany 1988-1994' (1995) *Cornell Review of the Convention on Contracts for the International Sale of Goods* 51, 62.

<sup>14</sup> Karollus (n 13) 62.

seller claimed for payment of the full price. The court did not have to decide the issue of fundamental breach since it held that there was no express declaration of avoidance of the contract. Nevertheless, the court noted in obiter dictum that even if the buyer was substantially deprived of what he was entitled to expect under the contract, the seller could not have foreseen the consequences. There is no fundamental breach if the seller, and any reasonable person of the same kind in the same circumstances, did not foresee where the second buyer's branches were located. An Italian shoe manufacturer who conducts his business in Germany by using a sales agent does not have knowledge of the German branches of its business partners.

This decision does not seem convincing to deny validity of avoidance in the sense of Article 26 CISG. There are two points that can be made about this decision. The first is that the court misapplied Article 26 CISG because the declaration of avoidance may take place expressly or impliedly. The conduct of the buyer in returning the goods and promising to pay the price of only 20 pairs represents an implied partial avoidance of contract. Secondly, the court applied Article 25 in determining the contractual expectations through the foreseeability test. In the court's opinion, foreseeability functioned to interpret the parties' intention of the contractual terms. Therefore, the court investigated the foreseeability of the detriment as a matter of fact and not as a defence for the breaching party; otherwise, it would seem unfair for the court in a civil litigation to invoke a defence for a party who did not claim such a defence. However, the court misinterpreted the contract. The exclusivity term should have been observed in determining fundamental breach. A court should have to weigh up the importance of the exclusivity term as to the buyer's interest. It is likely that such a term was decisive for the buyer to conclude the contract or at least to determine the total price of the transaction. A reasonable person of the same kind as the seller would not promise such exclusive delivery if he was unable to organize his distribution to meet the contractual obligations he had

undertaken. The court's misapplication of the foreseeability test risks encouraging sellers to engage in fraud by intentionally promising obligations that they are unable to keep. A seller who had promised exclusive delivery to the buyer is obliged to organize his future distributions in the way that meets his previous contractual obligations.<sup>15</sup> He should at least include a distribution prohibition clause in all his subsequent contracts related to the first buyer's area.

In *Marlboro shoes*<sup>16</sup> the failure to perform an accessory obligation was held to be a fundamental breach of contract. In this case, an Italian manufacturer undertook the obligation to refrain from marketing shoes with the 'M' designation according to specifications given by a German buyer and it agreed to produce 130 pairs of these shoes to be used as a basis for further orders. The manufacturer, at a trade fair, displayed some shoes produced according to these specifications and bearing a trademark of which the buyer was the licensee. When the manufacturer refused to remove these shoes, the buyer advised the manufacturer by telex one day after the fair that the buyer had discontinued the relationship and would not pay the 130 sample shoes which were no longer of any value to the buyer. In response to the seller's action, the court held that the contract had been timely and effectively declared avoided. The manufacturer's breach of the ancillary duty of preserving exclusivity constituted a fundamental breach of the contract under Article 25 CISG since it endangered the purpose of the contract to such a degree that, as was foreseeable to the manufacturer, the buyer had no more interest in the contract.

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<sup>15</sup> One view advanced is that a seller who engages commercial agents is liable for their actions under CISG Article 79(2) to the extent they concern his obligations. For this view see Karollus (n 13) 63. However, Article 79(2) CISG does not seem applicable in this particular situation since the seller's failure to perform his obligation of exclusivity was not due to the failure by a third person whom he has engaged to perform the whole or a part of the breached contract. The agent who has distributed the goods in the protected area was neither acting under the name of the seller nor was he a party to the breached contract. The breach was the responsibility of the seller.

<sup>16</sup> *Shoes Case* (n 13) 64.

It is important to try to understand how the court understood substantial detriment in this case. There was no proof that an immediate loss would be incurred whether monetary or of any other kind. However, the court found that the buyer's interest in the fulfilment of the contract ceased to exist as a consequence of the exhibition of the shoes at the trade fair. The refusal of the seller to remove the exhibition pieces severely disturbed the confidence of the buyer in the seller's readiness to adhere to the unwritten 'exclusivity stipulation' to refrain from delivering such shoes to third parties without permission, and this was capable of being known by the party in breach of the contract. Therefore, the buyer could not be expected to further adhere to the contract.<sup>17</sup> The exhibition of the shoes, although it did not constitute actual trading, represents a breach of trust in the seller's future adherence to the contractual terms and this was seen by the court as an immediate fundamental breach of contract that entitled the party to declare avoidance.

In a case involving the sale of cutlery,<sup>18</sup> a German plaintiff had produced sets of cutlery that had been ordered by a Swiss defendant. The buyer refused to accept the delivery and claimed that no contract had been validly concluded and that it was entitled to declare the contract avoided because of a violation of exclusive rights granted by the seller. The seller declared the contract avoided and sued the buyer for damages. The court found that the buyer had no right to declare the contract avoided according to Article 49(1)(a) CISG. Even though the violation of an agreement that granted exclusive rights might be a fundamental breach of contract, the buyer did not give sufficient proof under Swiss law that an agreement granting exclusive rights had been entered into. The court awarded damages of ten per cent of the purchase price to the seller.

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<sup>17</sup> *Shoes Case* (n 13).

<sup>18</sup> *Cutlery Case* Commercial Court Switzerland (26 September 1997).

The cases above show that the non-performance of an ancillary obligation does not necessarily result in fundamental breach. The court needs to resolve how a violation of an exclusivity term would have influenced the substantial detriment to the parties' interest. Avoidance in case of breach of exclusivity term is the more appropriate remedy when a contract calls for repeated acts of performance over a period of time, in particular in exclusive distribution agreements. Such contracts presuppose the continuation of a relationship based on personal trust and, therefore, a breach by one party which destroys that confidence should justify avoidance by the other.<sup>19</sup> A fundamental breach is proved by proving the existence of the exclusivity term and its breach by the other party.

## **6.2 Fundamental breach by the seller**

### **6.2.1 Non-delivery of goods or documents**

Buyers conclude a sales contract in order to obtain the goods and documents that they need and so definite non-delivery must be considered a fundamental breach of contract in the sense of Article 25 CISG independent of whether the non-delivery was due to objective or subjective impossibility. The seller may fulfil his obligation to deliver if he delivered the conforming goods and handed over the documents concerning them at the right place and at the due time.<sup>20</sup> Definite failure to deliver the goods or documents is a fundamental breach. In the *Timber* case<sup>21</sup> there was a contract for the purchase of timber to be delivered in instalments. The complete failure to deliver the first instalment while keeping the advance price was held to constitute a fundamental breach by the seller with respect to that delivery. In another case, it was held that, notwithstanding timely delivery of the good (a concrete

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<sup>19</sup> Koch (n 13) 354.

<sup>20</sup> The acts that the seller must do in order to transfer title to the buyer are not treated by the Convention according to Article 4(b) and the effects which the contract may have on the property in the goods sold is left to the law applicable under the conflict-of-laws rule of the forum; see Lando (n 6) 247.

<sup>21</sup> *Timber Case* Foreign Trade Court of Arbitration attached to the Serbian Chamber of Commerce, Serbia (1 October 2007).

block production machine), the seller had committed a fundamental breach as he had failed to provide the buyer with all the drawings and technical materials that were needed to complete the civil works for the installation of the machine as provided for under the contract.<sup>22</sup> The court considered the installation works as an important obligation and its non-performance entitled the innocent party to avoid the contract.

### **6.2.1.1 Fundamental breach as to place of delivery**

The place of performance of the seller's delivery obligation in international sales contracts is important within several topics, such as contract formation, dispute resolution,<sup>23</sup> allocating responsibility for export licenses and export taxes<sup>24</sup> and the passing of risk.<sup>25</sup> Place of delivery is usually agreed between the parties often when referring to clauses of the commercial terms, by including a clause to the effect that the contract is governed by the provisions of Incoterms.<sup>26</sup> If the parties did not agree on the place of delivery, delivery place is not to be determined by the domestic law applicable to the contract.<sup>27</sup> Article 31 CISG contemplates three possibilities. It differentiates between sales involving carriage and other sales. In a sale involving carriage of goods, the seller performs delivery by handing the goods over to the first carrier for transmission to the buyer. According to the Convention, this not

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<sup>22</sup> *Colour Concrete Block Production Line Case* CIETAC Arbitration Proceeding, China (30 June 2007); Carlo Mastellone, 'The Right to Avoid the Contract: The Concept of "Fundamental Breach" Under the CISG' (International Sale of Goods Commission, 55th UIA Congress Miami, Florida, United States, 31 October-4 November 2011) 'The Impact of the Uniform Sales Law on Drafting the Contract for International Sale' 10.

<sup>23</sup> Under Article 5(1) of the EC Convention on Jurisdiction and Enforcement of Judgement in Civil and Commercial Matters (16 September 1988) (Lugano Convention), a person domiciled in a contracting State may be sued in the court of the place of performance of the disputed obligation. See *Damstahl AS v ATI srl Højesteret* (Supreme Court), Denmark (15 Feb 2001); *Industrial Machinery Case* District Court Reggio Emilia, Italy (3 July 2000).

<sup>24</sup> Honnold (n 6) 243.

<sup>25</sup> Enderlein (n 5) chapter 5, 133, 145; Ronald A Brand, 'CISG Article 31: When Substantive Law Rules Affect Jurisdictional Results' (2005-06) 25 *Journal of Law and Commerce* 181, 182.

<sup>26</sup> Henry Gabriel, 'The International Chamber of Commerce INCOTERMS 1990 - A Guide to their Usage' (1999) 3 *Vindobona Journal of International Commercial Law and Arbitration* 61; Henry Gabriel, 'International Chamber of Commerce Incoterms 2000: A Guide to Their Terms and Usage' (2001) 5 *Vindobona Journal of International Commercial Law and Arbitration* 41, 43.

<sup>27</sup> *Airbag Parts Case* Appellate Court Dresden, Germany (11 June 2007).

only amounts to a delivery made to the buyer but also establishes whether the risk for the goods had passed to the buyer.<sup>28</sup> The fact that the buyer did not receive the goods or he received damaged-in-transit goods will not have any effect on the seller's compliance in any manner<sup>29</sup> nor will it entitle the buyer to withhold payment of the price unless the loss of goods or damage is due to an act or omission of the seller.<sup>30</sup>

In the other two situations of delivery, in the absence of an agreement to the contrary, the seller performs delivery when he places the goods 'at the buyer's disposal', that is, the contract calls for the buyer to take possession of the goods and the seller may dispose of them by instructing the buyer and/or by handing over the corresponding documents.<sup>31</sup> This performance indicates a duty to specify or at least to give precise identification of the goods by the seller and, in some circumstances, to prepare the goods as required, such as by packaging and notifying the buyer.<sup>32</sup> One possibility that Article 31(b) CISG provides for is where the seller has to place the goods at the buyer's disposal at the place where the goods were located at the time of contract formation. This situation may concern specific goods, for example, a machine or a car which the buyer is bound to pick up at the location known to the parties at the time when the contract was made or it may concern goods not yet identified or goods to be manufactured or produced. In case of doubt, the goods are to be placed at the buyer's disposal at the place where they are to be drawn from a stock or to be manufactured or produced. Examples of this might be a certain quantity of rocks from a quarry and a certain quantity of seeds from the next crop in a certain field. In these cases, the assumption of a

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<sup>28</sup> Articles 31a, 66 and 67 CISG (n 7); in case law see *Pizza Cartons Case* Lower Court Duisburg, Germany (13 April 2000).

<sup>29</sup> Unless agreed otherwise, see *Hartman LLC v Grlic Plus LLC* Appellate Court Montenegro (20 February 2007).

<sup>30</sup> Article 66 CISG (n 7).

<sup>31</sup> Peter Schlechtriem, 'The Seller's Obligations Under the United Nations Convention on Contracts for the International Sale of Goods' in Nina M Galston and Hans Smit (eds) *International Sales: The United Nations Convention on Contracts for the International Sale of Goods* (Matthew Bender 1984) chapter 6, 6-1 to 6-35, 6-9ff.

<sup>32</sup> Schlechtriem (n 10) 65.



corresponding intention is to be inferred from the parties' knowledge of the warehouse or place of manufacture. Absence of any different contractual provision is decisive for the buyer's obligation to come for the goods at the location. Another possibility, provided for by Article 31(c) CISG, is where the goods must be placed at the buyer's disposal at the seller's place of business. If the seller has no or more than one place of business, reference must be made to Article 10.<sup>33</sup> In these two situations, the passing of risk does not correspond to the act of delivery; the passing of risk may occur at a time other than the time of performance.<sup>34</sup>

Whether the seller has fundamentally breached his obligation to deliver with respect to place of delivery depends on yet another factor: the time of delivery. In general, 'questions as to "place" and "time" will merge into a single issue: Did the goods get to the agreed place on time?'.<sup>35</sup> Therefore, there is no fundamental breach if the seller is willing and able to bring those goods that were first delivered to the wrong place to the right place within a reasonable time, that is, before the delay in delivery can amount to a fundamental breach of contract.<sup>36</sup>

If the seller delivers the goods before the agreed upon date in the contract, it would be prejudicial to the buyer because he may not be ready to take the goods before the date agreed in the contract. The Vienna Convention provides a solution for such a breach by giving the buyer the right to refuse to take delivery if the goods are delivered by the seller before the agreed date. The seller bears the costs of returning or storing the goods until the delivery date. If the seller is unable to return the goods or to store them, the buyer is committed to take the goods for the benefit of the seller.

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<sup>33</sup> Article 10 CISG (n 7) 'For the purposes of this Convention: (a) if a party has more than one place of business, the place of business is that which has the closest relationship to the contract and its performance, having regard to the circumstances known to or contemplated by the parties at any time before or at the conclusion of the contract; (b) if a party does not have a place of business, reference is to be made to his habitual residence.'

<sup>34</sup> Schlechtriem (n 10) 64.

<sup>35</sup> Honnold, *Uniform Law for International Sales under the 1980 United Nations Convention*, (n 6) 243.

<sup>36</sup> The same solution was provided in Article 30 ULIS (Convention Relating to a Uniform Law for the International Sale of Goods (1 July 1964) 834 UNTS 169); see Schlechtriem (n 31) 6-16.

### 6.2.1.2 Time of delivery

The relevant time for delivery is primarily the date fixed by or determinable from the contract. The time of delivery may be fixed by a certain date or within a period of time. The seller will be in breach of contract if he fails to deliver by the fixed date. If the parties agree on a period of time during which delivery can be made, the seller is at liberty to choose a date within this period to deliver. In other words, goods should have been delivered before the end of the last day of the agreed period.<sup>37</sup> The agreement on a period often gives the party who is to choose a date the necessary flexibility to prepare the goods for delivery and arrange the transport. In certain circumstances, the buyer should choose a date. For example, if the buyer himself has to arrange the carriage of the goods or if he has to charter a vessel or reserve the necessary space on a vessel, as in the FOB clause, this should be taken as an indication that the buyer may choose a date of delivery within the agreed period.<sup>38</sup> If there is no express provision regarding the date of delivery, delivery must be made within a reasonable time after the conclusion of the contract. Obviously, the circumstances which play a part in construing the term 'reasonable time' are determined by factors such as how much time the arrangement of transportation requires, whether the seller has to obtain or manufacture the goods himself and so forth.<sup>39</sup> The seller will be in breach of his obligation to deliver if he fails to deliver within such a reasonable time. In general, late delivery will not be considered a fundamental breach unless other criteria qualify such late delivery as fundamental. This will be discussed over the next paragraphs.

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<sup>37</sup> *FCF SA v Adriafl Commerciale Srl* Supreme Court Switzerland 4C.105/2000 (15 September 2000).

<sup>38</sup> Enderlein (n 5) 152.

<sup>39</sup> Schlechtriem (n 31) 6-16.

### **6.2.1.3 Longer constant non-delivery**

The delay in delivery may constitute fundamental breach if it was continuous for a longer duration or it may amount as setting *Nachfrist* to the seller. In the *Rolled Steel* case a Spanish buyer ordered a set of parts for use in the buyer's production process from a German seller and it was agreed that the goods would be delivered by instalments. The seller consistently failed to meet the delivery deadlines so that three of the instalments were delivered after the agreed dates, with delays of between four and eight weeks. This caused inevitable disruption to the buyer's production process. In view of the situation, the buyer declared the contract avoided in respect of the outstanding future instalments within a period of 48 hours after delivery of the third overdue instalment. The Court held that the buyer's tolerance of the late delivery of the three initial instalments was equivalent to the granting of *Nachfrist* to the seller in accordance with Article 47 CISG.<sup>40</sup> The delay and its effect on the buyer's production process were deemed by the Court to amount to a 'fundamental breach' in conformity with Articles 33 and 49 CISG. The Court ruled that, in accordance with Articles 49(2) and 73 CISG, such a fundamental breach entitled the buyer to avoid the contract and prevent the handing over of future outstanding instalments. The 48-hour period within which the buyer cancelled following delivery of the last late instalment received was deemed a 'reasonable time' within which to declare the contract avoided.

### **6.2.2 Late delivery as fundamental breach**

With respect to the fundamentality of late delivery, the failure to meet the delivery deadline constitutes a fundamental breach of contract only if the buyer has a special interest in the delivery being on time and where the seller can foresee that the buyer would prefer non-delivery instead of late delivery. In all other situations, late delivery cannot be considered a

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<sup>40</sup> *Rolled Steel Case* Appellate Court Barcelona, Spain (3 November 1997).

fundamental breach within the meaning of Article 25 CISG.<sup>41</sup> Avoidance of the contract in the case of late delivery also requires either a late performance that amounts to fundamental breach due to non-delivery or a failure by the seller to deliver within *Nachfrist*.<sup>42</sup> This is an *e contrario* conclusion drawn from a comparison between Article 49(1)(a) and (b) CISG that a non-delivery or a mere delay in delivery does not in itself constitute a fundamental breach of contract under the meaning of Article 25 CISG and Article 49(1)(a) CISG. Otherwise, the provision in Article 49(1)(b) CISG would be superfluous and would not have been legislated since fixing a time limit would never be required.<sup>43</sup> In practice, however, the parties to a sale contract may have a special interest in punctual delivery; thus, there are exceptional cases where the late delivery is sufficiently late to deprive the buyer of substantially what he was entitled to expect under the contract. The question of whether the late delivery deprived the buyer of his contractual expectations must be determined according to the circumstances of each case. Many factors may be relevant. It is necessary for the parties to have shown a common intent that the whole transaction should ‘stand or fall’ on the timely delivery or that ‘time is of the essence’ under the contract.<sup>44</sup> The essentiality of timely delivery may be evident from an express stipulation on a fixed date, trade usage and other circumstances of the case.<sup>45</sup>

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<sup>41</sup> *Shoes Case* Appellate Court München, Germany (1 July 2002); *Shoes Case* Appellate Court Düsseldorf, Germany (24 April 1997); see also Andrea Björklund, ‘Article 25’ in Stefan Kroll and others (eds), *UN Convention on Contracts for the International Sale of Goods (CISG)* (CH Beck-Hart-Nomos 2011) para 33, 344.

<sup>42</sup> *Rare Hard Wood Case* Appellate Court Köln, Germany 22 February 1994; see also for a similar approach, *Fashion Textiles Case* Lower Court Oldenburg, Germany (24 April 1990); Karollus (n 13) 71.

<sup>43</sup> *Shoes Case* District Court München, Germany (20 February 2002); *Shoes Case* (n 41); *Shoes Case* Appellate Court Frankfurt, Germany (18 January 1994).

<sup>44</sup> *Memory Module Case* Appellate Court Hamm, Germany (12 November 2001); Schroeter (n 11) para 38, 418.

<sup>45</sup> Graffi (n 3) 342; Koch (n 13); Björklund (n 41) para 34, 344.

### 6.2.2.1 Parties' express stipulation on a fixed date

A breach of the time of delivery may constitute a fundamental breach of contract when the contract stipulates that delivery must be accomplished at an exact time or where the parties have agreed that the delivery should be executed as soon as possible. Equally, the existence of this clause can be inferred from using customary terms which stipulate that time is of the essence, such as 'fixed', 'absolutely', 'precisely', 'at the latest',<sup>46</sup> where the seller was or could have been aware of the buyer's urgent need of the goods.<sup>47</sup> Using such expressions can be considered as an agreement where untimely delivery will have to be regarded as a fundamental breach of contract. For example, a fundamental breach was held to have occurred in a case that involved the sale of mobile phones that were delivered nearly a week after the agreed date and where the contract included the expression *schnellstmöglich* (in the quickest possible way).<sup>48</sup> Furthermore, essentiality of punctual delivery may be evident by referencing particular Incoterms, such as CIF or FOB, although these terms do not necessarily transform a simple delay into a fundamental breach. A German court held that in the sale of a commodity whose price decreased quickly, the Incoterm CIF by definition determines the contract to be a time-of-the-essence transaction for delivery by a fixed date and gives the buyer the right to avoid the contract in the event of late delivery.<sup>49</sup>

### 6.2.2.2 Other factors that influence late delivery

Courts do not treat all cases of late performance as fundamental breach. The courts will be likely to investigate the seriousness of the breach in terms of its impact on the value of the

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<sup>46</sup> Enderlein and Maskow (n 9).

<sup>47</sup> Ulrich Magnus, 'The Remedy of Avoidance of Contract Under CISG: General Remarks and Special Cases' (2005-06) 25 *Journal of Law and Commerce* 423, 434.

<sup>48</sup> *Mobile Car Phones Case* Appellate Court Düsseldorf, Germany (21 April 2004); see also Magnus (n 47) 434.

<sup>49</sup> *Iron Molybdenum Case* Appellate Court Hamburg, Germany (28 February 1997); see also Magnus (n 47) 434. But CIF contracts have also been viewed differently as time of essence transactions even without further stipulation or circumstances. See Graffi (n 3) footnote 55; Koch (n 13) footnote 203.

goods and whether the buyer can still use the goods for the purpose originally intended. In the absence of express stipulation or an express provision that makes it clear that time is of the essence, the buyer's interests in punctual delivery can be determined in the light of the circumstances of the case, customs, usage or other relevant factors.<sup>50</sup> It could also be evidenced from the nature of the goods.<sup>51</sup>

#### **6.2.2.2.1 Time-sensitive goods**

Where the goods in question are of a time-sensitive character, such as fashionable or seasonal goods, late delivery generally constitutes a fundamental breach.<sup>52</sup> Some examples in the case law may clarify this point. In *Italdecor v Yiu's Industries*<sup>53</sup> a buyer ordered seasonal knitwear for an end of year sale with the following clause regarding delivery and payment: 'Delivery: 3rd December, 1990; Terms of payment: deposit: US \$6,000.00; Balance: bank cheque.' After the conclusion of the contract, the buyer pointed to the essential importance of delivery at the fixed date since the goods had to be sold during the Christmas period. Upon the seller's failure to deliver at the date fixed, the buyer declared avoidance of contract. The Court of Appeal held that the buyer was entitled to declare the contract avoided on the grounds of Article 45(1) and 49(1) CISG. The Court considered the precise text of the delivery clause and the seller's knowledge although it had been made after the conclusion of the contract. The Court found that the precise observance by the seller of the date of delivery was of fundamental importance to the buyer who expected to receive the goods in time, just before the end of year sales. Therefore, the non-delivery at the date fixed by the contract amounted to a fundamental breach by the seller as provided for in Article 25 CISG.

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<sup>50</sup> Article 8(2), (3) CISG (n 7); Graffi (n 3) 341.

<sup>51</sup> Alastair Mullis, 'Avoidance for Breach under the Vienna Convention; A Critical Analysis of Some of the Early Cases' in M Andreas and N Jarborg (eds), *Anglo-Swedish Studies in Law* (Lustus Forlag 1998) 326, 353.

<sup>52</sup> Freiburg (n 11) 76.

<sup>53</sup> *Italdecor v Yiu's Industries* Appellate Court Milan, Italy (20 March 1998); see also Graffi (n 3) 341.

In this case, there was no express agreement on strict compliance with the date of delivery. It is questionable whether an implicit agreement can be inferred lightly from the circumstances, ie, from the nature of the goods and the buyer's indication of the fixed date of delivery. However, it seems that the seller's knowledge of the importance of timely delivery was decisive for the establishment of fundamental late delivery. The court interpreted the contract according to the buyer's intent which was that the goods were to be resold at that fixed time. Consequently, the late delivery was fundamental since the buyer was deprived of what he was entitled to expect under the contract and the seller was aware of this outcome of his breach.

However, there is no fundamental breach if the agreed date for delivery was only very slightly missed (by 1 or 2 days). For instance, in the German *Clothes* case it was held that a delivery of summer clothes one day after the fixed time did not constitute a fundamental breach.<sup>54</sup> In a similar context, it was held that the inconvenience caused by dispatching goods (women's wear) two days after the stipulated time was only of minor importance to the buyer and did not amount to fundamental breach.<sup>55</sup> In addition, the seller's obligation to deliver on time, with respect to fashionable goods, can be perceived to be flexible if the parties referred to the delivery dates with the symbols '+/-'. In case law, a contract for the sale of fashionable goods contained the clause 'to be delivered July, August, September +/-'. The first delivery was attempted on 26 September. Due to late delivery of the July and August instalments, the buyer refused to accept the goods and returned the invoice on 2 October. The court did not consider that the buyer had a right to avoid the contract on fundamental breach according to Article 49(1)(a) nor did it consider the period of nearly two months as implicitly setting *Nachfrist*. The court held that a *Nachfrist* notice must be sent for each delayed instalment in

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<sup>54</sup> *Clothes Case* District Court Oldenburg, Germany (27 March 1996); see also Schroeter (n 11) para 40, 419.

<sup>55</sup> *Clothes Case* Lower Court Ludwigsburg, Germany (21 December 1990); affirmed by *Women's Clothes Case* District Court Stuttgart, Germany (13 August 1991); see also Koch (n 13) footnote 206.

order to avoid the contract later on the basis of Article 49(1)(b) CISG.<sup>56</sup> In a commentary on this decision, it was stated that the symbols ‘+/-’ could have been interpreted as an indication of the parties’ intention that a delayed delivery would not constitute fundamental breach.<sup>57</sup> However, taking into account the timely character of the goods, it is difficult to completely agree with such an interpretation at least with respect to the July and August instalments according to Article 73(1) CISG. It may be argued that the buyer was not entitled to declare avoidance for the July and August instalments because he had not done so within a reasonable time. However, this is a separate issue that the court should have considered independently from the occurrence of fundamental breach.

#### **6.2.2.2 Preventing buyer’s resale business**

Where the seller had knowledge that the buyer needed the goods by a certain date in order to resell the goods to a third party, for instance, when the buyer has informed the seller that he has fixed a date for delivery to his sub-buyers, the seller’s late delivery may be considered a fundamental breach as it results in preventing the buyer from performing an existing obligation that fulfils his own obligations toward third parties.<sup>58</sup> This is because the buyer has almost certainly suffered a substantial deprivation under Article 25 CISG. The buyer will then be entitled to avoid the contract if the seller or a reasonable seller had foreseen that the delay in delivery would have this substantial effect.<sup>59</sup> In a case that involved the late delivery of chemical fertilizer, the ICC Court of Arbitration in Basel held that a fundamental breach had occurred because the seller knew that the buyer had to pay a contractual penalty as well as additional costs incurred from a substitute purchase of goods if he failed to deliver the

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<sup>56</sup> *Fashion Textiles Case* (n 42).

<sup>57</sup> Karollus (n 13) 71.

<sup>58</sup> Graffi (n 3) 341.

<sup>59</sup> Joseph Lookofsky, ‘Article 49: Buyer’s Right to Avoid for Seller’s Breach’ in J Herbots and R Blanpain (eds), *The 1980 United Nations Convention on Contracts for the International Sale of Goods, International Encyclopaedia of Laws - Contracts*, Suppl 29 (Kluwer Law International December 2000) 1; Koch (n 13) 265.



goods to a third party. The Court asserted the principle that avoidance for late delivery is to be exercised via *Nachfrist*, but late delivery, as in the case at hand, may constitute fundamental breach if it appears from the circumstances that the date of delivery is of particular significance to the buyer and that the seller has knowledge thereof.<sup>60</sup>

#### **6.2.2.2.3 Late delivery of commodities and goods with volatile market prices**

A feature of the sale of commodities is that the goods sold are subject to major fluctuations in price and they are easily obtainable in the market. Late delivery has been viewed as a fundamental breach where goods sold are subject to such fluctuations as is the case in the commodities markets or when they are to be used for the production of goods with volatile market prices. Late delivery of these sorts of goods means that they can eventually only be sold for a lower price, and therefore late delivery is fundamental breach.<sup>61</sup> There are two arguments in favour of this view but there are also obstacles in its way. According to the first argument, the gravity of the untimely delivery breach can be derived from the contract itself since the importance of time and strict compliance is self-evident in these markets; therefore, ‘the implicit agreement may be inferred from the circumstances that even a short delay should entitle the buyer to declare the contract avoided’.<sup>62</sup> The reason for treating untimely delivery in this market as fundamental is the fact that the buyer should not bear the risk of a dramatic price drop and the further risk of the seller’s eventual insolvency due to that drop.<sup>63</sup>

Another view supports this solution not by arguing over the bases of party autonomy and implicit agreement but rather by attempting to implant a time-of-the-essence condition into

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<sup>60</sup> *Chemical Fertilizer Case* ICC Arb Case No 8128 (1995); *FCF SA v Adriaafil Commerciale Srl* (n 37).

<sup>61</sup> Schroeter (n 11) para 39, 419.

<sup>62</sup> Magnus (n 47) 435.

<sup>63</sup> *ibid* 435.

Article 25 CISG.<sup>64</sup> It has been said that in cases of the buyer's rejection of the goods alleging late shipment, 'a court applying the Vienna Convention is unlikely to reach a radically different solution to a court applying English law'.<sup>65</sup> It is well known that in a commodity sale governed by English law, non-compliance with the time condition results in a hair-trigger right of termination even if the buyer accepted the documents and the buyer was a non-consumer.<sup>66</sup>

However, both of the above views have been criticized. A different view presents a strong objection to any reasoning without express or implied agreement clarify avoidance of a commodity sale upon untimely delivery under CISG because such an interpretation is tantamount to an attempt to modify the CISG, in particular, Article 25 CISG.<sup>67</sup> Although an implied derogation from Article 25 CISG is certainly permitted, it is not to be lightly inferred from the trade environment in which the parties operate. While the perceived importance of timely delivery in the trade in commodities may overcome any difficulties posed by foreseeability, it is not sufficient alone to generate a contrary intention for the purpose of party autonomy; in particular, when the parties themselves show no intention to depart from the clear wording of Article 25 CISG. The drafting history of Article 25 CISG precludes identifying fundamental breach by reference to the importance of contractual terms or by

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<sup>64</sup> CISG Advisory Council, 'Opinion No 5, The buyer's right to avoid the contract in case of non-conforming goods or documents' (7 May 2005) 4.17; Alastair CL Mullis, 'Termination for Breach of Contract in CIF Contracts under the Vienna Convention and English Law: Is There a Substantial Difference?' in Eva Lomnicka and CGJ Morse (eds), *Contemporary Issues in Commercial Law: Essays in honour of Prof AG Guest* (Sweet and Maxwell 1997) 137; Katrina Winsor, 'The Applicability of the CISG to Govern Sales of Commodity Type Goods' (1/2010) 14 *Vindobona Journal of International Commercial Law and Arbitration* 83, 103.

<sup>65</sup> Mullis (n 64).

<sup>66</sup> Stipulations as to the time and place of shipment form part of the description of the goods and failure to comply with a description entitles the buyer to reject even where the late shipment caused the buyer no loss. It is questionable whether statutory reform presented by section 15A of the Sale of Goods Act 1979 applies to the time and documentary obligations. According to prevailing view, commodity sales are *ring-fenced* from this statutory change. See Michael G Bridge, 'Uniformity and Diversity in the Law of International Sale' (Spring 2003) 15 *Pace International Law Review* 55, 69.

<sup>67</sup> Michael Bridge, 'Avoidance for Fundamental Breach of Contract under the UN Convention on the International Sale of Goods' (2010) 59 *International and Comparative Law Quarterly* 911, 935.

reference to anything other than the consequences of a particular breach. In addition, the history of the buyer's avoidance provisions in Article 49 CISG indicates a conscious movement away from strict right of avoidance in the case of documentary sales known under the ULIS. A related provision in Article 28 ULIS which laid down a special rule of avoidance for late delivery in the case of market-quoted goods<sup>68</sup> was not repeated in the CISG. Therefore, asserting that in commodities sales late delivery is always considered a fundamental breach is an attempt to revive an abolished feature of the ULIS.<sup>69</sup> This view concludes that the test for a fundamental breach in the CISG is unsuitable to be used in the trading environment where strict performance is favoured, and any attempt concluding otherwise is one which tries to 'make up for deficiencies in the drafting of the CISG'.<sup>70</sup> According to this view, a late delivery of commodities or goods with a quoted stock or market price does not constitute a fundamental breach under the CISG in the absence of express or implied agreement to that effect.

The later view illuminates the fact that implanting the English conditions rules into the CISG is not acceptable. It is not possible to accept that the word 'lightly' is the precise characterisation of the inference of the timely delivery rule in the CISG's commodities market. In practice, commercial terms, such as Incoterms rules and UCP, have become an essential part of the daily sales of commodities that help to build up most of the deficiencies attributed to the definition in Article 25 CISG.<sup>71</sup> If the commercial terms used were impartial as to the importance of timely delivery, the trade environment in which the parties operate

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<sup>68</sup> Article 28 ULIS (n 36) provides for 'failure to deliver the goods at the date fixed shall amount to a fundamental breach of the contract whenever a price for such goods is quoted on a market where the buyer can obtain them'.

<sup>69</sup> Bridge (n 67) 935.

<sup>70</sup> *ibid* 935.

<sup>71</sup> 'A vast amount of world trade is commodity related and all standard term commodity contracts issued by the commodity associations routinely exclude Vienna.' Mullis (n 51) 355; Winsor (n 64); Bruno Zeller, 'Commodity Sales and the CISG' in Camilla B Andersen and Ulrich G Schroeter (eds), *Sharing International Commercial Law across National Boundaries: Festschrift for Albert H Kritzer on the Occasion of his Eightieth Birthday* (Wildy, Simmonds and Hill 2008) 627.

does help to infer a workable solution by invoking Articles 8 and 9 CISG in conjunction with the principle of fundamental breach without the need to implant into the CISG the English judge-made conditions.<sup>72</sup> Unlike English law, the CISG's threshold to avoid the contract comes with the foreseeability component that by its interpretive function offers an aid to decide whether the contract is a time-of-the-essence transaction. Interpretation of the foresight of the reasonable person of the same kind as the seller in the commodities market provides buyers with a reasonable reliance that they are concluding a contract with a reliable seller who can weigh up the importance of his obligations, including timely delivery, in the environment in which they operate. This reliance is of significant importance to encourage the players in international sales to buy with confidence when the parties may not know each other well. The seller's actual or presumed knowledge of the importance of timely delivery is sufficient to establish his responsibility over a short delay.<sup>73</sup> It would be unreasonable for a seller to ignore the importance of timely delivery in the commodities market. However, the buyers cannot benefit themselves from the rule of foresight of a reasonable seller if they did not rely or it was unreasonable for them to rely on the seller's skill and knowledge and, in general, if the seller's skill and judgment capacity is not common in the seller's trade branch. From this perspective, it seems that the CISG's rules of avoidance, although not as opportunistic as English conditions,<sup>74</sup> are suitable for various types of sales environments with the potential ability for development according to the circumstances of the trade provided that courts applying the Convention give sufficient weight to the commercial

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<sup>72</sup> As Will has pointed out, it is not the injured parties' personal hopes which are considered, instead, the injured parties' expectations are judged objectively taking account of the type of contract concluded, the commercial background, and all the terms of the contract; M Will, 'Article 25' in Bianca and Bonnell (n 6) 213; see also Mullis (n 51) 349; Zeller (n 71).

<sup>73</sup> It is suggested that recourse to Articles 6 and 9 CISG (n 7) may enable a court to find fundamental breach where commercial circumstances require a right of avoidance for trivial breaches. See Mullis (n 51) 350.

<sup>74</sup> Avoidance in cases of non-conforming documents, non-conforming delivery under CISG may be subject to the right of cure which does not result in strict right of avoidance. See Articles 37, 48 CISG (n 7). See also the effect of curability on avoidance below.

background when considering whether to allow avoidance for fundamental breach.<sup>75</sup> As for the history of Article 49 CISG, the CISG was intended to reflect the default rules that most parties would bargain. The CISG would reduce the time and effort and, thus, the transaction costs that the parties must invest to reach agreement. Because the Convention was not intended to interfere with the freedom of sellers and buyers in international sales contracts,<sup>76</sup> there is no reason to believe that not replicating Article 28 ULIS in the CISG would indicate a legislative intention to adopt a particular regime of avoidance that was resistant to the commodities trade environment.<sup>77</sup> However, it must be admitted that the omission of explicit rules governing the avoidance in the documentary sales represents a defect in the CISG. Therefore, to avoid uncertainty it would be advisable for the parties involved in commodities trade not only to settle the importance of timely delivery but to expressly agree whether or not they intend to derogate from the CISG in their transaction.

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<sup>75</sup> It is a concern how the courts applying the Convention are likely to deal with cases involving sales of commodities. The principle of *favor contractus* may lead the courts to ignore the commercial background and to give too much emphasis to the policy of keeping contracts going. See Mullis (n 51) 355.

<sup>76</sup> Honnold (n 6) 4; Lars Meyer, 'Soft Law for Solid Contracts: A Comparative Analysis of the Value of the UNIDROIT Principles of International Commercial Contracts and the Principles of European Contract Law to Process of Contract Law Harmonization' (Spring 2006) *Denver Journal of International Law and Policy* 119; Larry A DiMatteo, 'Contract Talk: Reviewing the Historical and Practical Significance of Principles of European Contract Law' (Summer 2002) 43 *Harvard International Law Journal* 569. For criticisms over whether the CISG has failed to achieve this goal see Gilles Cuniberti, 'Is the CISG Benefiting Anybody?' (2006) 39 *Vanderbilt Journal of Transnational Law* 1511, 1524.

<sup>77</sup> The text of the Secretariat Commentary to Article 49 in case of non-conforming documents, for example, reads as follows: 'The rule that the buyer can normally avoid the contract only if there has been a fundamental breach of contract is not in accord with the typical practice under c.i.f. and other documentary sales. Since there is a general rule that the documents presented by the seller in a documentary transaction must be in strict compliance with the contract, buyers have often been able to refuse the documents if there has been some discrepancy in them even if that discrepancy was of little practical significance.' United Nations, 'Commentary on the Draft Convention on Contracts for the International Sale of Goods prepared by the Secretariat' UN Doc A/CONF.97/5.

## **6.3 Breach by the buyer**

Case law provides examples of fundamental breaches in three types of contract violations, namely, failure to pay the price, failure to take delivery of the goods, and non-performance of other obligations imposed by the contract on the buyer.

### **6.3.1 Fundamental breach due to non-payment**

#### **6.3.1.1 Determination of the price**

Price is usually determined at the formation of the contract either by stating the price of the goods or providing a formula or other method by which the price of the goods can be determined. However, if the parties say nothing about the price, Article 55 CISG presumes that the parties have adopted ‘the price generally charged at the time of the conclusion of the contract for [similar] goods sold under comparable circumstances in the trade concerned’. This Article is only interpretive for the parties’ intention because the contract cannot be validly concluded without fixing the price expressly or implicitly. Article 14 CISG requires a definite proposal to conclude the contract. A proposal is sufficiently definite if it indicates the goods and expressly or implicitly fixes or makes provision for determining the quantity and the price.<sup>78</sup> Accordingly, it seems that the open price rule, as found in UCC 2-305, has no place in a CISG contract because Article 55 CISG is applicable only to validly concluded contracts.<sup>79</sup> Therefore, a statement which is intended as an offer but which lacks a definite

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<sup>78</sup> E Allan Farnsworth, ‘The Buyer’s Obligations under the Convention on Contracts for the International Sale of Goods’ in Galston and Smit (n 31) chapter 3, 3-9; Denis Tallon, ‘The Buyer’s Obligations under the Convention on Contracts for the International Sale of Goods’ in Galston and Smit (n 31) chapter 7, 7-1 to 7-20; Gyula Eörsi, ‘Article 14’ in Bianca and Bonell (n 6) 132, 7-10; Leif Sevón, ‘Obligations of the Buyer under the UN Convention on Contracts for the International Sale of Goods’ in Sarcevic and Volken (n 5).

<sup>79</sup> But see different view that supports the open price rule and argues that: ‘The only rule of “validity” with respect to agreement on price results from the opening phrase of Article 55 which defers to applicable domestic law” See Honnold (n 6) 155. See also Joseph Lookofsky, ‘Article 55 Contract With “Open” Price Term’ in Herbots and Blanpain (n 59) 1, 130; Paul Amato, ‘UN Convention on Contracts for the International Sale of Goods: The Open Price Term and Uniform Application: An Early Interpretation by the Hungarian Courts’ (1993) 13 *Journal of Law and Commerce* 1; Ewoud Hondius, ‘CISG and a European Civil Code: Some

price will be treated as an invitation to make an offer while the reply by an addressee constitutes an offer if it was sufficiently definite.<sup>80</sup> In case of a dispute, such as over the acceptance of delivered goods or other situations that show an intention to be bound, either party to a disadvantageous transaction may rebut the presumption of generally charged price if he purports another ground for price determination such as price of earlier transactions or the price of favourable buyers. The result of the dispute should be settled subjectively and objectively according to Articles 8 and 9 CISG. There are likely to be situations where the parties normally waiving price negotiations depend on price transparency given at the market, and this provides for the possibility of forming a contract without a fixed or determinable price. If there was no common intention to be concluded then invalidating the contract due to the lack of definite price requirements should not be considered regrettable because the contract was void from the outset.<sup>81</sup>

The application of the open price rule also confirms the prevalence of the parties' common intention. However, if such an intention could not be concluded, this would result in replacing the indefinite price with the price generally charged if it had to interpret Article 55 CISG similarly to the known open price rule under UCC 2-305. This solution, although practicable, does not seem reconcilable with Article 14(1) CISG because Article 55 CISG only comes into operation if a contract has been validly concluded; however, the contract cannot be concluded due to the indefiniteness of the price. The open price rule interpretation would be acceptable if Article 55 CISG were in Section II, which regulates formation of the

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Reflections, The 25th Anniversary, its Impact in the Past, its Role in the Future' (German Society of Comparative Law, Private International Law Division Conference, Würzburg, 22-24 September 2005) in (January 2007) 71 *Rechts Zeitschrift für Ausländisches und Internationales Privatrecht* 99.

<sup>80</sup> Schlechtriem (n 10) 52.

<sup>81</sup> The situation in case law appears to be similar. See *Implicit Agreement on Price Case* Tribunal of International Commercial Arbitration at the Russian Federation Chamber of Commerce and Industry, Russia 309/1993 (3 March 1995); *Special Screws Case* Appellate Court Frankfurt, Germany (4 March 1994); *Pratt and Whitney v Malev* Supreme Court Hungary (25 September 1992); *Cutlery Case* (n 18); *Alain Veyron v Ambrosio* Appellate Court Grenoble, France (26 April 1995).

contract, rather than in Section III, which deals with the rights and the obligations of the parties to a valid contract. One more point that can be used to oppose the application of the open price rule is the fear that international buyers may feel at the prospect of being obliged to pay the price generally charged by the seller rather than the market price for merely contemplating the seller's invitation to make an offer. These fears are more real in transactions of certain types of merchandise where only the seller controls the price, for example, in absolute monopoly markets.

### **6.3.1.2 Obligation to pay**

In international sales contracts it is very common to have provisions that expressly specify how the payment should be made. The payment may be made either by advance payments (usually only partial payments) or by procurement of securities for payment as letters of credit, surety-ship, guarantees, indemnities and pledges. When nothing has been agreed upon in the contract, the buyer has to pay according to Articles 57 to 59 CISG. The individual acts to be performed by the buyer in order to effect payment may be a transfer of the funds or the handing over of cash or cheque.<sup>82</sup> In addition, the buyer's obligation to pay includes all of the measures agreed upon in the contract that enable the payment to be made. Such measures are the duty to provide a letter of credit and to comply with relevant domestic laws, to establish a security or obtain a bank guarantee, or to accept a bill of exchange. The buyer's failure to comply with any of these obligations represents a failure to pay the price which may or may not amount to fundamental breach.<sup>83</sup>

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<sup>82</sup> Dietrich Maskow, 'Article 58' in Bianca and Bonell (n 6) 394, 395.

<sup>83</sup> Article 54 CISG, which provides that "The buyer's obligation to pay the price includes taking such steps and complying with such formalities as may be required under the contract or any laws and regulations to enable payment to be made." See: Schlechtriem (n 10) 81; Honnold (n 6) 351-352; Denis Tallon, *The Buyer's Obligations Under the Convention on Contracts for the International Sale of Goods*, in Galston and Smit (ed), *International Sales: The United Nations Convention on Contracts for the International Sale of Goods*, (Matthew Bender, 1984), Ch. 7, pages 7-1 to 7-20.



### **6.3.1.3 Place of payment**

Payment is to be made at the place agreed upon by the parties, either expressly or implicitly. There are two possibilities if the parties failed to designate a place of payment in the contract. When the parties have agreed that payment is to be made against the handing over of the goods or of documents then the place of payment is the place where this is to happen according to the contract or the Convention, namely, Articles 31 and 34. When the parties have not even agreed to this, the place of payment is the seller's place of business.<sup>84</sup> The same rules apply to determine the currency of payments.<sup>85</sup>

### **6.3.1.4 Time of payment**

International sales contracts frequently prescribe the time when the payment needs to be made or when the letter of credit needs to be opened. Usually, the buyer has to act in advance, that is, before the seller starts the process of delivery. The date for the performance has to be agreed upon; however, Article 58 CISG sets the time for payment in the absence of a contrary agreement. The default rule provides that payment is due at the time the goods or documents representing the goods are put into the buyer's control. The documents, however, must provide the buyer with the right to receive the goods. Documents such as certificates of origin and quality and customs documents, which do not provide the buyer with the right to take possession of the goods, do not trigger the buyer's obligation to pay for the goods under Article 59 CISG.

If the goods are to be shipped against procurement of securities, in the absence of any contrary agreement between the parties, then the buyer may provide such securities within a

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<sup>84</sup> Dietrich Maskow, 'Article 57' in Bianca and Bonell (n 6) 412.

<sup>85</sup> Henry D Gabriel, 'The Buyer's Performance Under the CISG: Articles 53-60 Trends in the Decisions CISG' (2005-2006) 25 *Journal of Law and Commerce* 273.

reasonable time by taking into consideration the function of these securities.<sup>86</sup> In the *Australian Raw Wool* case<sup>87</sup> there was no express term in the contract as to the time when the letter of credit should be opened. The seller claimed that, according to the standard practice of China Tex Raw Materials Trading Corporation, the buyer should have opened the letter of credit fifteen days before the date of shipment; the seller asserted that the letter of credit was opened too late. This had led him to avoid the contract, sell the goods to a third party and claim his loss of profit. The arbitrators declined to recognise the practice cited by China Tex Raw Materials Trading Corporation and instead referred to the provision in Article 9(2) CISG. The arbitrators explained that a buyer is only obliged to open the letter of credit within a reasonable time before shipment and, thus, in the case at hand, the buyer did not open the letter of credit late.

Unlike in many domestic laws, the buyer will be in delay once he fails to pay the price by the due date without any affirmative action or formal or informal request by the seller on the payment date. Therefore, according to Article 78 CISG, interest is due from the day the payment was first considered late.<sup>88</sup>

#### **6.3.1.5 Breach of obligation to pay**

The buyer's definitive failure to pay the price or a large part of the price generally constitutes a fundamental breach of contract because it substantially deprives the seller of what he was entitled to expect under the contract. The longer the delay in payment the more a breach becomes fundamental and so the seller will always be entitled to avail himself of the right to avoid the contract in the event of non-payment.

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<sup>86</sup> Maskow (n 82); Gabriel (n 85).

<sup>87</sup> *Australian Raw Wool Case* CIETAC Arbitration Proceedings, China (6 January 1999).

<sup>88</sup> Gabriel (n 85).

The definitive failure to pay the price will often be derived from a declaration by the buyer that he will not settle the price or the buyer's insolvency situation. A frequent litigious situation is the buyer's refusal to pay the price on the ground that the contract is not valid or the contract is avoided due to an alleged fundamental breach. This could happen when the seller's breach was not fundamental or if the buyer declared avoidance of contract outside the reasonable time limitation according to Article 49(b) CISG.

In addition, under Article 72 the seller may avoid the contract if prior to the date for performance of the contract it is clear that the buyer will commit a fundamental breach of contract unless the buyer provides adequate assurances of his performance. The serious worsening of creditworthiness of the buyer may play a role in determining whether a fundamental breach of contract is committed, such as in the case of advance payment or if it is clear that the buyer will not be in a position at the time of delivery to open a letter of credit. In *Roder v Rosedown*<sup>89</sup> the buyer was placed under administration after he encountered acute financial difficulties and fell into arrears with his payments to the seller. The seller demanded that the administrator deliver up possession of the goods on the grounds that the contract of sale contained retention of title clause whereby title to the goods did not pass to the purchaser until the purchase price had been paid in full. The administrator denied the existence of such a clause and refused to return the goods. The court held that the fact that the company was insolvent or was likely to become so and the placement of the company under administration resulted in such a detriment to the seller so as to substantially deprive him of what he was entitled to expect under the contract. The denial by the administrator of the existence of a retention of title term in the contract also amounted to fundamental breach within the meaning of Article 25.<sup>90</sup> In the *Shoes* case, which involved successive sale,<sup>91</sup> the Court held

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<sup>89</sup> *Roder v Rosedown* Federal District Court Adelaide, Australia (28 April 1995).

<sup>90</sup> Koch (n 13) 246.

that the seller had the right to declare the second contract avoided under Article 72(1) and (2) CISG since even before the delivery of the goods it was clear that the buyer would not pay the purchase price and would thereby commit a fundamental breach of contract. The buyer had not performed under the prior contract although the seller had requested it several times and had even commenced a legal action.<sup>92</sup>

### **6.3.1.6 Late payment and delay in opening the documentary credit**

In cases involving late payment due to the late opening of documentary credits, courts have not been prepared to treat breach by late performance or non-performance as fundamental in the absence of a failure to perform within an additional period of time as set out in Articles 47 or 63. It is generally acknowledged that mere delay to pay the price when due does not amount to a fundamental breach. The buyer's late payment can only be treated as a fundamental breach in exceptional cases where the timely performance of the obligation to pay the price is of the essence to the contract. Several courts have held that the buyer's short delay in making payment is a non-fundamental breach of contract under the CISG and does not entitle the seller to avoid the contract.<sup>93</sup> Since it is often hard to determine when delay may amount to fundamental breach in cases of late payment, it is always advisable that the seller fix an additional term for the buyer to make payment (*Nachfrist*). At the expiration of this term, the aggrieved seller will be entitled to avoid the contract pursuant to Articles 64(1)(b) if the buyer fails to pay the price within that period.<sup>94</sup>

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<sup>91</sup> *Shoes Case* District Court Krefeld, Germany (28 April 1993).

<sup>92</sup> *Shoes Case* Appellate Court Düsseldorf, Germany (14 January 1994).

<sup>93</sup> *Downs Investment v Perwaja Steel* Supreme Court of Queensland, Australia (17 November 2000); *Foamed Board Machinery Case* ICC Arb Case No 7585 (1992); *Failure To Open Letter Of Credit And Penalty Clause Case* ICC Arb Case No 7197 (1992).

<sup>94</sup> *Downs Investments v Perwaja Steel* Supreme Court of Queensland, Australia (12 October 2001); See also Graffi (n 3) 342.

The failure to open a letter of credit at the time fixed by the contract does not automatically constitute a fundamental breach.<sup>95</sup> Several courts have ruled that the buyer's failure to open a letter of credit in the time fixed in the contract does not constitute a fundamental breach and that the seller may declare the contract avoided only after the expiry of the additional term for performance granted to the buyer.<sup>96</sup> Thus, when a buyer and a seller agree in their contract of sale that payment should be effected by the furnishing of a letter of credit, it puts the buyer under an obligation to have such a letter of credit opened by a bank in favour of the seller. This is a condition precedent to the performance of all the seller's duties and clearly falls within the buyer's control. Failure to comply would be the buyer's sole responsibility and constitutes a breach of contract which may not be considered a fundamental breach only in such cases where the seller needs payment to be made by letter of credit in order to secure the procurement on his part of the required materials.<sup>97</sup>

However, late payment may be considered fundamental in cases of longer delay. In the *Foamed Board Machinery* case<sup>98</sup> the arbitrator held that although a delay in opening the documentary credit in itself did not necessarily amount to a fundamental breach, the seller was entitled to avoid the contract. In the arbitrator's opinion, the fact that the seller waited several months before declaring the contract avoided could be considered equivalent to the fixing of 'an additional period of time' for performance according to Article 63 CISG, with

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<sup>95</sup> But there is a different view that the seller should always be allowed to declare the contract avoided if the buyer does not open the credit within the fixed time. See Jan Hellner, 'The Vienna Convention and Standard Form Contracts' in Sarcevic and Volken (n 5) chapter 10, 335, 353.

<sup>96</sup> *Downs Investment v Perwaja Steel* (n 93); *Foamed Board Machinery Case* (n 93); *Failure To Open Letter Of Credit And Penalty Clause Case* (n 93); See also Graffi (n 3).

<sup>97</sup> Enderlein and Maskow (n 9) 244.

<sup>98</sup> *Foamed Board Machinery Case* (n 93).

the result that the failure by the buyer to perform within that period of time entitled the seller to avoid the contract pursuant to Article 64(1)(b) CISG.<sup>99</sup>

In addition, late payment may be considered a fundamental breach when the parties have expressly made time of the essence in the contract or where there is a rapid decline in currency.<sup>100</sup>

### **6.3.2 The obligation to take delivery**

#### **6.3.2.1 Elements of taking delivery**

The buyer's obligation to take delivery consists of two elements. The first is the requirement to undertake necessary acts that enable the seller to make delivery, such as obtaining the necessary import documents, making the preparations for any installation to be done by the seller, and specifying and requesting delivery of the goods ordered unless the contract or circumstances require the seller to undertake such acts. The second element is that the buyer must take possession of the goods. Taking physical possession of the goods may be accomplished in several ways. Where the goods are to be placed at the disposal of the buyer then he is normally responsible for removing the goods. The buyer who fails to take over the goods in time will bear the risk of accidental loss or damage after that time. Unless the goods are placed at the buyer's disposal at their final destination, the buyer must usually provide the means of transportation agreed. The buyer also has to take the goods when the contract does not involve carriage of the goods but the seller is nevertheless obliged to arrange for their transportation. The buyer's failure to take over the goods from the carrier will constitute a breach, and the buyer may well be liable to provide the seller with compensation for extra costs paid to the carrier in this regard. Where documents are required in order to enable the

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<sup>99</sup> Louis F Del Duca and Patrick Del Duca, 'Selected Topics under the Convention on International Sale of Goods (CISG)' (Summer 2001) 106 Dickinson Law Review 205, 240.

<sup>100</sup> Enderlein and Maskow (n 9) 224; Kazimierska (n 9).

buyer to take delivery, such as a bill of lading in sea transport, the obligation to take over the goods includes the obligation to accept the documents if tendered in conformity with the contract.<sup>101</sup>

### **6.3.2.2 Fundamental breach for failure to take delivery**

The buyer's failure to take delivery of the goods may deprive the seller of what he was entitled to expect under the contract. If the seller made the timely taking of delivery an essential duty, for example, when the seller needs to clear his warehouse, the seller may require the buyer to take delivery rather than avoid the contract for fundamental breach. However, such a remedy of specific performance is subject to a limitation under Article 28 CISG.<sup>102</sup>

Several courts have held that the final refusal by the buyer to take over the goods constitutes fundamental breach if it was an indication of an anticipatory breach of the obligation to pay the price in cases where the seller had granted the buyer a credit.<sup>103</sup> In the *Frozen Bacon* case<sup>104</sup> the court held that the seller was entitled to declare the contract avoided because the buyer's failure to take delivery of more than half of the goods constituted a fundamental breach of contract as set out in Article 64(1)(a) CISG. The buyer, after taking delivery of the first 4 out of 10 instalments, refused to take delivery of the remaining 6 instalments.

In case of late taking of the goods by the buyer, a delay in taking delivery is to be regarded as a fundamental breach in 'just-in-time' contracts when the goods are of a perishable nature or

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<sup>101</sup> Dietrich Maskow, 'Article 60' in Bianca and Bonell (n 6) 435; Honnold (n 6) 373; Joseph Lookofsky, 'Article 60: Taking Delivery' in Herbots and Blanpain (n 59) 133.

<sup>102</sup> Sevón (n 78) chapter 6 at 230 et seq.

<sup>103</sup> *Ng Nam Bee Pte Ltd v Tay Ninh Trade Co* Appellate Court Vietnam (5 April 1996); *Cutlery case* (n 18); *Frozen Bacon Case* Appellate Court Hamm, Germany (22 September 1992).

<sup>104</sup> *Frozen Bacon Case* (n 103).

where the goods cannot be stored.<sup>105</sup> However, it has been held that a delay of only a few days does not constitute a fundamental breach. The buyer could not be expected to have understood that a few days' delay in taking delivery would constitute a fundamental breach on its own.<sup>106</sup> In case of a longer delay which results in considerable costs of storage, the seller should still not be entitled to declare the contract avoided but simply to claim damages.<sup>107</sup>

## 6.4 Conclusion

The fundamentality of the breach for non-performance can be better understood by reference to the nature of the breach, whether it was an ultimate failure to perform or a delay in performance. The ultimate failure to perform the obligations to deliver the goods, to pay the price, and to take delivery is a fundamental breach because the parties conclude the contract in order to obtain the counter performance. Late performance, as a general rule, does not constitute fundamental breach unless agreed otherwise. The court may conclude the importance of timely performance of the contract by reference to the contractual agreement or by reference to the nature of the goods or the market in which the parties operate, such as a volatile market price. In cases of late performance, it is advisable for the innocent party to avoid the contract by setting a *Nachfrist* procedure.

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<sup>105</sup> Koch (n 13) at 109.

<sup>106</sup> *Ego Fruits v La Verja Begastri* Appellate Court Grenoble, France (4 February 1999).

<sup>107</sup> Graffi (n 3).



## Chapter Seven: Fundamental breach for non-conformity

The issue of when non-conformity becomes a fundamental breach is the most difficult and recurrent question in international sales litigation. A great number of court decisions have been rendered in this area but it has been rather problematic to establish what types of deficiencies in the goods may amount to a fundamental breach.<sup>1</sup> However, due to the difficulties in proving substantial detriment, it is rare that the non-conformity of the goods reaches the threshold of fundamental breach, which would justify avoidance pursuant to Article 49(1)(a). One reason for this is the difficulty of establishing the essential detriment or proving that the avoidance had been declared within a reasonable time.<sup>2</sup>

In determining what type of deficiency may lead to fundamental non-conformity, the court should weigh up various elements related to substantial deprivation of contractual expectations. This fact makes it difficult to distil one single approach from case law that can be attributed to court practices. However, some authors have observed various approaches in groups of cases, such as an economic approach based on the actual loss suffered by the aggrieved party<sup>3</sup> or a remedy-oriented approach based on the fitness of the goods for the intended purpose.<sup>4</sup> These observations only indicate that there are factual common denominators in given groups of cases and it has not been suggested that they are suitable approaches to apply to similar cases. One court decision may fall under two of these approaches or all of them. The applicable approach for the purposes of this thesis is to view

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<sup>1</sup> Peter Huber, 'CISG: The Structure of Remedies' (January 2007) 71 *Rechts Zeitschrift für Ausländisches und Internationales Privatrecht* 13, 25; Leonardo Graffi, 'Case Law on the Concept of "Fundamental Breach" in the Vienna Sales Convention' (2003) 3 *International Business Law Journal* 338, 342.

<sup>2</sup> Stefan Kroll, 'The Burden of Proof for the Non-Conformity of Goods under Article 35 CISG' (2011) 3 *Belgrade Law Review*, Year LIX 162, 167.

<sup>3</sup> Graffi (n 1) 345.

<sup>4</sup> Robert Koch, 'The Concept of Fundamental Breach of Contract, Review of the Convention on Contracts for the International Sale of Goods (CISG) 1998' (1999) *Kluwer Law International* 177, 222; Graffi (n 1) 342.

the alleged detriment in the light of the parties' declared intention as interpreted by the respective courts.

## **7.1 Overview of defective performance as fundamental breach**

### **7.1.1 Comparative observations**

The concept of lack of conformity under CISG differs materially from its counterparts in most comparative laws on liability for delivery of defective goods. The Convention introduces lack of conformity as a uniform concept which includes not only differences in quality but also differences in quantity, and defects in packaging and legal defects.<sup>5</sup> In the civil law systems that were originally based on the rules of the Roman law of sale, termination for non-conformity has been regarded as a rather easily available remedy.<sup>6</sup> In the case of defects in the quality of the goods, the buyer had the right either to demand a reduction of the purchase price (*actio quanti minoris*) or to avoid the contract (*actio redhibitoria*).<sup>7</sup> The issues of hidden defects and third party rights on the delivered goods are governed by a special warranty against hidden defects and a warranty against eviction respectively. In common law, the seller's breach, which is based on delivery of non-conforming goods, is governed by the so-called 'perfect tender rule' which gives the buyer the right to reject the goods if they do not conform to the contract in any respect. If the buyer has accepted the goods, he may be entitled to avoid the contract if the seller was in breach of condition.<sup>8</sup>

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<sup>5</sup> Ingeborg Schwenzer, 'Article 35' in Ingeborg Schwenzer (ed), *Schlechtriem and Schwenzer, Commentary on the UN Convention on the International Sale of Goods (CISG)* (3rd edn, Oxford University Press 2010) para 4, 570.

<sup>6</sup> Huber (n 1) 18. For more detailed comparison see John C Reitz, 'A History of Cut off Rules as a Form of Caveat Emptor: Part II - From Roman Law to the Modern Civil and Common Law' [1989] 37 *The American Journal Of Comparative Law* 248, 253.

<sup>7</sup> CISG Advisory Council, 'Opinion No 5, The buyer's right to avoid the contract in case of non-conforming goods or documents' (7 May 2005).

<sup>8</sup> Section 13 and following of the English Sale of Goods Act 1979.

In addition, according to a prevalent view in CISG doctrine the distinction between *peius* and *aliud* delivery, used in former German law and Austrian law, has no role to play under the Convention because the concept of non-conformity encompasses the delivery of *aliud* goods. The CISG does not contain any express rule that specifically addresses this problem of the delivery of *aliud* goods as lacking conformity or constituting non-delivery. According to the prevailing view, this question does not constitute a gap in the CISG. Therefore, there is no need to resort to the general principles of the Convention or to domestic law. The delivery of goods of a different kind, no matter how significant the deviation is, constitutes non-conformity under the CISG.<sup>9</sup> This view is supported by the fact that the relevant CISG provisions that deal with the seller's obligations do not differentiate between the delivery of *aliud* or *peius* and allow for the conclusion that both have to be treated equally.<sup>10</sup> For the purpose of contract avoidance, it would be much safer for the buyer to qualify an *aliud* delivery as a non-delivery to avoid the contract via *Nachfrist*. The buyer would be much less expected to use goods of a different kind than the goods he ordered for his contractual purpose. In cases of blatant deviation, the more extreme the deviation, the easier it will be to classify non-conformity as a fundamental breach of contract.<sup>11</sup>

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<sup>9</sup> Fritz Enderlein and Dietrich Maskow, *International Sales Law: United Nations Convention on Contracts for the International Sale of Goods Convention on the Limitation Period in the International Sale of Goods* (Oceana 1992) 142; John Honnold, *Uniform Law for International Sales Under the 1980 United Nations Convention* (3rd edn, Kluwer Law International 1999) 279; CM Bianca, 'Article 35, Conformity of Goods' in CM Bianca and MJ Bonell (eds), *Commentary on the International Sales Law: The 1980 Vienna Sales Convention* (Giuffrè 1987) 273; Martin Karollus, 'Judicial Interpretation and Application of the CISG in Germany 1988-1994' (1995) *Cornell Review of the Convention on Contracts for the International Sale of Goods* 51, 68.

<sup>10</sup> *Used Automobiles Case* Supreme Court Spain (17 January 2008); Robert Koch, 'Commentary on Whether the UNIDROIT Principles of International Commercial Contracts May Be Used to Interpret or Supplement Articles 47 and 49 of the CISG' (December 2004) <<http://www.CISG.law.pace.edu/CISG/biblio/koch2.html>> accessed 22 January 2014.

<sup>11</sup> Peter Schlechtriem, 'Uniform Sales Law in the Decisions of the Bundesgerichtshof: 50 Years of the Bundesgerichtshof. A Celebration Anthology from the Academic Community' para III <<http://CISGw3.law.pace.edu/CISG/biblio/schlechtriem3.html>> accessed 22 January 2014.

## 7.1.2 The relevant time of non-conformity

### 7.1.2.1 The general rule

The general rule concerning the time of conformity is explained under Article 36(1) CISG:

The seller is liable in accordance with the contract and this Convention for any lack of conformity which exists at the time when the risk passes to the buyer, even though the lack of conformity becomes apparent only after that time.<sup>12</sup>

If the goods are not in conformity at the time when the risk passes, the buyer is entitled to exercise the remedies available to him under Article 45 CISG. However, if the goods were conforming at the time when the risk passed to him, the buyer is obliged to pay for the goods even if they subsequently deteriorate before delivery. The goods must be in conformity at the time when risk passes from the seller to the buyer. The time at which risk passes to the buyer is to be determined according to the party autonomy principle. This time may either be expressly determined by the contract, by trade usage, or alternatively by Articles 66 to 70 CISG.<sup>13</sup> For example, where a contract for the sale of dried mushrooms included a 'C & F' clause, and the mushrooms deteriorated during shipment, one court found that the C & F clause obliged the seller to hand over the goods to the carrier and to pay for the freight. However, the C & F clause does not affect the passing of the risk.<sup>14</sup> The court held that the risk passed to the buyer when the goods were handed over to the first carrier for transmission to the buyer according to Article 67 CISG. The lack of conformity occurred after risk of loss had passed and the seller was therefore not responsible for it under Article 36(1) CISG.<sup>15</sup>

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<sup>12</sup> Article 36(1) United Nations Convention on Contracts for International Sale of Goods (11 April 1980, entered into force 1 January 1988) 1489 UNTS 3 (CISG).

<sup>13</sup> Alastair Mullis, 'Obligations of the seller' in Peter Huber and Alastair Mullis, *The CISG: A new textbook for students and practitioners* (Sellier 2007) 144.

<sup>14</sup> In C and F (or CFR) the risk is transferred to the buyer when the goods are loaded on the ship in the country of origin.

<sup>15</sup> *Bedial v Muggenburg* Appellate Court Argentina (31 October 1995); see also Mullis (n 13) 144.

However, the seller will be liable for any lack of conformity of the goods that exists at the time when the risk passes to the buyer even though the lack of conformity became apparent only subsequently. In the Belgian *Frozen Pork* case<sup>16</sup> a Belgian seller and a German buyer concluded a contract for the sale of pork to be resold to the buyer's final customers. Shortly after delivery, the pork was suspected of having been contaminated with dioxin. As a result, the German government ruled that the purchase of pork from Belgium would have been possible only if the Belgian seller had certified the pork as being non-contaminated; concomitant with the EU rules that require the absence of dioxin to be certified in the whole of the EU. Since the seller had not complied with this requirement, the German authorities seized the pork and the buyer refused to pay the purchase price. The seller brought an action to recover the purchase price. The first instance court ruled that a suspicion of a health-threatening condition of the goods had to be regarded as a lack of conformity even if the suspicion arose after the passing of risk, pursuant to Articles 36 and 67(1) CISG, as long as the facts on which the suspicion was based existed before that time. According to the court, it did not matter if those facts were known or unknown at the time of the passing of risk. There was evident suspicion that the pork sold might be contaminated because of facts pre-existing the passing of risk; thus, the court concluded that the pork did not conform to the contract. The Appellate Court upheld the lower court's decision.

#### **7.1.2.2 Lack of conformity after the risk has passed (Article 36(2) CISG)**

The seller is liable for a lack of conformity which occurs after the time indicated in Article 36(1) CISG and where that lack of conformity is due to a breach of any of the seller's obligations; for example, a breach of any guarantee that the goods will remain, for a period, fit for their ordinary purpose, or for some particular purpose, or will retain specified qualities

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<sup>16</sup> *Frozen Pork Case* Appellate Court Frankfurt, Germany (29 January 2004).

and characteristics.<sup>17</sup> There are two situations which can be envisaged. The first one is where the seller's breach occurs prior to the passing of risk but causes a lack of conformity to arise at a later time after the risk has passed. For example, in the *Medical Equipment* case<sup>18</sup> the seller was required by the terms of the sales contract to conclude a contract by transporting the goods by air but he changed the type of transportation and loaded the equipment into a container which was delivered to a ship. This caused a delay of twelve days and the goods were damaged by the carrier after risk had passed. The sole arbitrator found that the seller was liable for deterioration of the goods although no lack of conformity of the goods existed at the time risk passed to the buyer.

The second situation stems from the fact that some contractual warranties include undertakings that extend beyond delivery. For example, the guarantee that the goods will remain fit or will retain specified qualities for a certain period. Under these warranties, the buyer would not be required to prove that there was non-conformity when risk passed, for example, on shipment of the goods or delivery to the buyer.<sup>19</sup>

Some authors doubt the easy understanding of the main thrust of the rule in Article 36(2) CISG. In cases where the seller breaches a guarantee that the goods will remain fit or will retain specified qualities, the breach has already occurred at the time of delivery in that, for example, a seller who delivers washing machines which are guaranteed to last 3 years commits a breach at the moment he delivers goods not capable of lasting three years. Moreover, since such breaches of guarantees should be seen as falling within the general rule in Article 36(2) CISG, it is doubtful if it adds anything to Article 36(1) CISG.<sup>20</sup> In addition, Article 36(2) raises the problem of whether the fitness of the goods for their ordinary

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<sup>17</sup> Article 36(2) CISG (n 12).

<sup>18</sup> *Medical Equipment Case* Arbitration Proceeding Ukraine (5 July 2005).

<sup>19</sup> Honnold (n 9) 265; Joseph Lookofsky, 'Commentary' in J Herbots and R Blanpain (eds) *International Encyclopaedia of Laws - Contracts*, Suppl 29 (Kluwer Law International December 2000) 100.

<sup>20</sup> Mullis (n 13) 146; Lookofsky (n 19) 100.

purposes includes a certain durability, ie whether the goods should remain fit or perform satisfactorily for a reasonable length of time. This question may be answered differently in different national systems. The negative solution requires an express contractual guarantee in order to make the seller liable for a short duration because durability is a special quality of the goods. However, the prevalent solution in accordance with the Convention instead favours the inclusion of a reasonable duration among the ordinary qualities of the goods. Even without an express guarantee, the buyer may expect the goods to last for a normal amount of time. Indeed, goods cannot be said to be fit for their normal purposes when they only endure for an exceptionally short period. The suitability for ordinary purposes must extend beyond the time the goods are accepted. An exceptionally short duration is not a question of poor quality. It means, rather, that the goods do not meet what may be considered a reasonable expectation of the buyer according to the Convention's standards of fairness.<sup>21</sup>

However, it seems that the application of Article 36(2) may provide an answer to the question of which of the parties has to bear the burden of proof as to the conformity of goods at the time of passing of risk. As the CISG does not contain any particular rule on the burden of proof, it seems that after taking delivery without giving notice of the lack of conformity the buyer must allege and prove that the goods do not conform with the contract whereas the seller does not have to allege and prove that they do conform with the contract upon delivery to the first carrier. Damage to goods may happen in various settings, for example, they may be destroyed on the seller's premises, during loading or upon arrival at the buyer's premises.<sup>22</sup> In *Thermo King v Cigna Insurance*<sup>23</sup> the court presumed the seller's liability with

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<sup>21</sup> Bianca (n 9) 289; Peter Schlechtriem, *Uniform Sales Law - The UN-Convention on Contracts for the International Sale of Goods* (Manz 1986) 68.

<sup>22</sup> Neil Gary Oberman, 'Transfer of risk from seller to buyer in International Commercial Contract: A comparative analysis of risk allocation under the CISG, UCC and Incoterms' (Master Thesis, University of Montreal, June 1997).

<sup>23</sup> *Thermo King v Cigna Insurance* Appellate Court Grenoble, France (15 May 1996).

regard to the defects of the refrigeration units, noting that the unit had broken down within a short period after it was first operated. The Court of Appeals held that, as the sale involved carriage of the goods, the risk had passed to the buyer when the identified goods were handed over to the carrier in Ghana for transportation, pursuant to Article 67 CISG. The Court also noted that in this case it was necessary to ascertain whether the goods lacked conformity upon their being handed over to the carrier. The mere fact that before shipment the surveillance authority had certified the conformity of goods is no evidence of the buyer accepting the goods as such because the certificate of quality is intended only for the seller to receive payment by letter of credit. In the situations where the test made before shipment of the goods was mistaken or where the goods had deteriorated during the period before being closed into the containers and shipped or where the goods lacked conformity upon passing of the risk but the defects became apparent only after their arrival at the port of destination, the goods were defective when handed over to the carrier for transportation. Therefore, the seller was in breach for non-conformity unless he provided evidence of the real cause of lack of conformity that existed after the risk passed to the buyer.<sup>24</sup>

### **7.1.3 Non-conformity and error at contract formation**

If parties agree to a sale of brand accessories made of jewels and gold but there is a misunderstanding about the materials used, and if it is only discovered after delivery and inspection that they are made of glass and golden-dyed cheap silver, then it is arguable whether this situation can be equated with cases of non-conformity, at least under some domestic jurisdictions. The error in the things sold results in the contract being not validly concluded because acceptance does not correspond to the offer.<sup>25</sup> In such a situation, the

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<sup>24</sup> *Thermo King v Cigna Insurance* (n 23); *Cocoa Beans Case* Appellate Court Lugano, Cantone del Ticino, Switzerland (15 January 1998).

<sup>25</sup> Where the parties have erred the very substance of the named and identified object of the contract, the contract's effects will pertain only to the named object; therefore, the contract is void (not valid) due to non-



court should first decide whether a contract could validly be concluded where its subject matter did not exist or where the minds of the parties had objected to goods that were completely different to the ones that ought to have been delivered. However, the non-validity of the contract because of error will be decided according to the domestic law and this might provide various solutions.

#### **7.1.4 Non-conformity as fundamental breach**

The Convention's rules on non-conformity, as provided in Article 35 CISG, emphasize the priority of the general principle of party autonomy expressed in Article 6 CISG.<sup>26</sup> According to Article 35(1) CISG, the seller must deliver goods which are of the quantity, quality and description required by the contract and which are contained or packaged in the manner required by the contract. Article 35(2) CISG determines the presumed intent of the parties in the absence of a contrary contractual agreement. The goods do not conform to the contract unless they meet four objective criteria. This paragraph of Article 35(2) CISG may be considered an objective interpretation of the parties' intention and thus it is of particular importance to the test of fundamental non-conformity. The interpretative criteria under this paragraph are the fitness of the goods for their ordinary purpose or the particular purpose agreed by the parties and the possession of the qualities which the seller has shown the buyer in a sample or model and that are contained or packaged in the manner that is usual for such goods or, where there is no such manner, in a manner adequate to preserve and protect the goods.<sup>27</sup> However, according to paragraph 3 of Article 35, the fact that the buyer could not

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existence of the named substance. However, if the error rests on the description of that substance (such as round gemstone rather than square), the contract is valid but revocable.

<sup>26</sup> Article 35(1) CISG (n 12) provides that: 'The seller must deliver goods which are of the quantity, quality and description required by the contract and which are contained or packaged in the manner required by the contract.'; Article 6 CISG provides that: 'The parties may exclude the application of this Convention or, subject to article 12, derogate from or vary the effect of any of its provisions.'

<sup>27</sup> Article 35(2) CISG (n 12) provides that: 'Except where the parties have agreed otherwise, the goods do not conform with the contract unless they: (a) [A]re fit for the purposes for which goods of the same description

have been unaware of a lack of conformity excludes the seller from his liability under Article 35.<sup>28</sup> The exclusion of the seller's liability in accordance with Article 35(3) CISG applies only to Article 35(2) CISG. Therefore, the analogous application of the disclaimer is to be rejected in Article 35(1) CISG.

Whether discrepancies in quality constitute a fundamental breach depends on proving a substantial detriment to the buyer's interests as a result of the breach of contract. Except where the parties have agreed otherwise, implied terms relating to fitness for the usual purposes, fitness for particular purposes, compliance with sample and usual packaging may ascertain the substantiality of the detriment to the buyer. The additional factor of whether it is possible to cure the defect may also enter into the equation.<sup>29</sup>

## **7.2 Non-conformity due to failure to comply with marketing regulations of the buyer's country**

Parties engaged in international commerce may fail to satisfy the standards of the commercial sphere which influence the ability to use the goods and distribute them in the buyer's country. The violation of public law regulations, cultural traditions or ideological and other convictions may well result in goods, in particular, food and drink, being unsaleable, although violation of such standards must not necessarily represent a defect in quality

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would ordinarily be used; (b) [A]re fit for any particular purpose expressly or impliedly made known to the seller at the time of the conclusion of the contract, except where the circumstances show that the buyer did not rely, or that it was unreasonable for him to rely, on the seller's skill and judgment; (c) [P]ossess the qualities of goods which the seller has held out to the buyer as a sample or model; (d) [A]re contained or packaged in the manner usual for such goods or, where there is no such manner, in a manner adequate to preserve and protect the goods.'; see also Kristian Maley, 'The Limits to the Conformity of Goods in the United Nations Convention on Contracts for the International Sale of Goods (CISG)' (2009) 12 *International Trade and Business Law Review* 82, 95.

<sup>28</sup> *Schlechtriem and Schwenger* (n 5) para 5, 570.

<sup>29</sup> Ingeborg Schwenger, 'The Danger of Domestic Pre-Conceived Views with Respect to the Uniform Interpretation of the CISG: The Question of Avoidance in the Case of Non-Conforming Goods and Documents' (2005) 4 *Victoria University of Wellington Law Review* 795; Alastair Mullis, 'Avoidance for Breach under the Vienna Convention: A Critical Analysis of Some of the Early Cases' in M Andreas and N Jarborg (eds), *Anglo-Swedish Studies in Law* (Lustus Forlag 1998) 326.

assuming that the respective goods are perfectly merchantable in some other countries.<sup>30</sup> If the buyer in such a case is deprived from resale opportunities because of deviations in the goods from local marketing requirements, the questions arise as to which party bears the burden of complying with such marketing standards and whether avoidance of contract would be permitted for fundamental breach. Should the goods comply with the norms in the seller's country or the buyer's, or some other norms? This issue of conformity of goods was evidently overlooked at the creation of the CISG,<sup>31</sup> while several examples in case law show apparently contradictory answers that govern the interpretation of fundamental breach. Accordingly, examples of the case law in this area are divided into two groups in order to specify the criteria.

### **7.2.1 Sample cases**

The following cases share the same type of dispute, where the buyers attempted to avoid the contract upon breach of conformity and this frustrated the contract purpose. The detriment was the failure of the goods to comply with the local marketing requirements in the buyer's country in the absence of an express contractual agreement or guarantee for such compliance. In the first group the courts favoured maintaining the contract while in the second group the courts ruled in favour of avoidance.

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<sup>30</sup> For example, food made of pork is unsaleable in most parts of Muslim countries due to the common convention of not eating pork as set out in the Holy Quran regardless of whether the country's law permits or prohibits such sales.

<sup>31</sup> Enderlein and Maskow (n 9) 144; Bianca (n 9) 282; Peter Schlechtriem, 'Compliance with local law: seller's obligation and liability, Annotation to German Supreme Court decision of 2 March 2005 [VIII ZR 67/04]' (December 2005) para I <<http://www.CISG.law.pace.edu/cisg/biblio/slechtriem7.html>> accessed 20 January 2014.

### 7.2.1.1 The first: Cases ruled in favour of maintaining the contract

In the well-known and controversial<sup>32</sup> case of *New Zealand mussels*,<sup>33</sup> a Swiss seller delivered mussels from New Zealand to the buyer's storage facility in Germany. The mussels were declared 'not completely safe' due to contamination by cadmium exceeding the recommended, but not mandated, limits under German law by more than 100 to 200 per cent. However, even though they were potentially toxic, they were acceptable in other countries such as New Zealand, the country where they came from, and Switzerland, the seller's place of business. In any case, the mussels were not permitted to be delivered out of the buyer's storage facility. The buyer declared the contract avoided on the ground that the goods delivered could not be used for their intended purpose (resale) in Germany, where the buyer had its place of business.

The German Supreme Court (BGH), following the prevailing opinion in the legal literature,<sup>34</sup> held that compliance with specialized public law provisions of the buyer's country or the country of use cannot be expected and that Article 35(2)(a) and (b) CISG do not place an obligation on the seller to supply goods which conform to all statutory or other public provisions in force in the import country. The German Supreme Court rejected the decision of the lower court that the excessive quantity of cadmium could affect the conformity of the goods. The standards for cadmium content in fish, in contrast to the standards for meat, do

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<sup>32</sup> See Honnold (n 9) 257; Karollus (n 9) 51; Franco Ferrari, 'Specific Topics of the CISG in the Light of Judicial Application and Scholarly Writing' (1995) 15 *Journal of Law and Commerce* 1; Harry M Flechtner, 'The Several Texts of the CISG in a Decentralized System: Observations on Translations', Reservations and other Challenges to the Uniformity Principle in Article 7(1)' (1998) 17 *Journal of Law and Commerce* 187; Graffi (n 1) 338; Teija Poikela, 'Conformity of Goods in the 1980 United Nations Convention of Contracts for the International Sale of Goods' (2003) 1 *Nordic Journal of Commercial Law* 54; Schlechtriem (n 31) para I; René Franz Herschel, 'Conformity of Goods in International Sales Governed by CISG Article 35: Caveat Venditor, Caveat Emptor and Contract Law as Background Law and as a Competing Set of Rules' (2004) 1 *Nordic Journal of Commercial Law* 7.

<sup>33</sup> *New Zealand Mussels Case* Supreme Court Germany (8 March 1995).

<sup>34</sup> The fitness of the goods measured against the standards in the seller country; see Bianca (n 9) 274; Enderlein and Maskow (n 9) 144; UG Schroeter, 'Article 25' in *Schlechtriem and Schwenzler* (n 5) para 14, 406; further resources cited in the court decision, *New Zealand Mussels Case* (n 33).

not have a legally binding character but only an administratively guiding character. The mussels did not lack conformity since they were fit for ordinary use by consumers and the parties had not agreed on a contamination threshold. The court asserted that domestic regulations had no role to play in determining whether the goods conformed to the contract under Article 35(2)(a) CISG. In fact, in the BGH's view these should be ignored with the aim of interpreting the Convention in a unified fashion.<sup>35</sup>

This approach was confirmed again by the Austrian Supreme Court (OGH) in a case that involved a German seller and an Austrian buyer over the sale of four machines, one of which had presumably been imported from the Czech Republic or Slovakia.<sup>36</sup> Pursuant to EC Directive 89/392 and in conjunction with the German law on machinery, CE labelling is a mandatory requirement for every machine imported from outside the European Economic Area (EEA) prior to putting it into circulation. The buyer had been assured of being able to sell the machines on the market within the EEA. However, the four machines that were delivered did not carry the European Community CE mark. Out of the four machines, two were sold but the others were not. The buyer refused to pay the rest of the purchase price on the ground that the machines were not suitable for resale within the EEA because of the missing CE labelling. The court of first instance found that the buyer was entitled to retain the price since the seller had not fulfilled the condition of resale-ability within the EEA. However, the Supreme Court directed the lower court of first instance to determine which security provisions and standards had to be applied and whether the machines complied with such provisions. The Court noted that whether the goods are fit for the purposes for which the goods of the same description would ordinarily be used is to be based on the standards in the

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<sup>35</sup> The buyer also complained about defects in the packaging but he delayed in declaring the contract avoided. The buyer had not given timely notice of the non-conformity of packaging. Notice was given approximately two months after delivery.

<sup>36</sup> *Machines Case* Supreme Court Austria (13 April 2000).

country of the seller; the goods need not meet the security, certification and production standards of the importing country. Consequently, the seller was not obliged to follow these legal standards even though the seller was aware of the place of delivery. It was up to the buyer to consider these requirements and to incorporate them into the contract on the ground of Article 35(1) or 35(2)(b) CISG.

#### **7.2.1.2 The second: Cases ruled in favour of buyer's country standards**

In contrast to *New Zealand Mussels*, in *Spanish Paprika* the *Landgericht Ellwangen* found that the delivery of paprika that contained a substance<sup>37</sup> in a quantity greater than the levels admitted by German law amounted to a fundamental breach as it deprived the buyer of what he was entitled to expect from the contract.<sup>38</sup> In the Court's opinion, the parties in the light of their previous commercial relationships had impliedly agreed that the goods should comply with the standards provided by the German law on food. Accordingly, the seller could not invoke lack of foreseeability of such provisions.

In a case that involved artificially sugared wine, the French Supreme Court shifted the risk of the goods' non-compliance with local merchantability regulations to the seller and assumed fundamental breach of contract (Article 25 CISG) without further discussion to justify avoidance. In this case, the seller treated the wine by adding sugar to it, in breach of French wine regulations. The Court held that fundamental breach occurred because of the seller's failure to deliver wine that was suitable for consumption in France. This fact was decisive in

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<sup>37</sup> The paprika contained ethyl oxide approximately 150% greater than the maximum concentration admissible under German food and drug law.

<sup>38</sup> Articles 35(1) and 25 CISG (n 12); *Spanish Paprika Case* District Court Ellwangen, Germany (21 August 1995); Koch (n 4) 236.

detecting fundamental breach although the wine could still be tradable for industry purposes.<sup>39</sup>

Similarly, the Grenoble Court of Appeal in the case of *Parmesan Cheese* considered the practices established between the parties and the dealings carried on between the parties for a number of months in order to decide whether the breach of packaging amounted to a fundamental breach. The Court observed that, as the parties were in a business relationship, the seller knew that the goods were to be resold in France. Therefore, pursuant to Article 8(1) CISG, the seller had to interpret the buyer's statements in the sense that the buyer wished to purchase goods conforming to French law and this included their merchantability in France. Consequently, the goods delivered by the seller did not conform since they were not wrapped in the manner required by French law as the composition and 'best before' dates were not printed on the wrapping.

A similar dispute in the US centred on the standards of the seller's place of business and the buyer's controls. A US District Court confirmed an arbitration award that ruled in favour of the laws of the buyer's place of business. The case involved delivery of medical equipment (mammography units) imported from Italy that was to be distributed in America by a trading company located in Louisiana. The US Food and Drug Administration (US FDA) seized the goods due to their failure to comply with US safety standards. The American party avoided the contract and sought damages before an arbitral tribunal. The arbitrators confirmed the avoidance of the contract and awarded damages to the plaintiff because the defendant had delivered units that failed to comply with US safety standards. The defendant challenged the award because the goods did comply with Italian safety standards and the arbitrators had

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<sup>39</sup> *Sacovini/M Marrazza v Les fils de Henri Ramel* Supreme Court France (23 January 1996); Koch (n 4) at note 221; Peter Schlechtriem, 'Cour de Cassation, 23 January 1996' (1997) IPRax 126, commented on by Peter Schlechtriem, 'Wesentlicher Vertragsbruch durch Lieferung gezeckerten Weins' (1997) IPRax 132; Graffi (n 1) 343.

misapplied the CISG in refusing to follow a German Supreme Court case interpreting the CISG (*New Zealand Mussels*). In reviewing the arbitral award, the District Court considered that the arbitral tribunal had carefully weighed up the German decision and correctly ruled that the standards of the buyer's country were applicable as an exception because the seller had or could have had knowledge of such provisions due to the particular circumstances of the case.<sup>40</sup>

### **7.2.2 Different criteria in the cases discussed above**

The reasoning in the cases discussed above is based on the requirement of fundamental breach in the sense of Article 25 CISG, the definition of non-conforming goods according to Article 35(2) CISG and the absence of an express contractual agreement. However, the application of these two articles gives rise to very great difficulties. Avoidance was denied in some cases while it was accepted in other cases although all these cases shared the fact that the buyer had essentially been deprived of what he was entitled to expect under the contract.

There is no doubt that the buyer's purpose in *New Zealand Mussels* had been entirely frustrated because, due to the contamination, he was not allowed to take the goods out of his storage facility. He could not find customers or retailers who were willing to buy such contaminated mussels before the 'expiration date' affixed to the merchandise by the seller had passed and the goods were finally disposed of by the health authorities. In the litigation, the seller did not claim non-foreseeability of such a result perhaps because performing delivery of the goods to the buyer's facility in Germany indicated his knowledge that the buyer intended to resell the goods in Germany, ie the seller could have foreseen such a result had he known that the goods were not fit for the German market. However, the facts are that:

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<sup>40</sup> *Medical Marketing v Internazionale Medico Scientifica* Federal District Court Louisiana, United States (17 May 1999); Harry M Flechtner, 'The Several Texts of the CISG in a Decentralized System: Observations on Translations, Reservations and other Challenges to the Uniformity Principle in Article 7(1)' (1998) 17 *Journal of Law and Commerce* 187, 210.



(1) the Court found that the goods were in conformity with the contract since there was no specific level of contamination agreed upon; and (2) the Court denied fundamental breach of the contract because the mussels were usually eaten in small amounts thus it was unlikely that the contaminated mussels, which were perfectly tradable abroad, would cause serious disease to consumers in Germany. Such findings are contrary to the approach that weighs up the essential detriment with an eye on the consequences of the breach. The buyer's purpose in the contract was obviously frustrated because he did not intend to eat the mussels but to trade them in Germany where they had been declared unfit for resale.<sup>41</sup>

The decision in *New Zealand Mussels* soundly defines the relationship between the essential detriment required to classify the breach as fundamental and the foreseeability requirement. However, it must be admitted that such a definition does not appear very clearly in the judgment. Whether the buyer was entitled to receive mussels fit for the German market is a question of contract interpretation. If the intention of the parties were objectively interpreted, in the absence of a particular agreement, it would be sufficient for the seller to deliver mussels that conformed to an ordinary quality standard as acknowledged in the Convention.<sup>42</sup>

It was primarily the buyer's responsibility to communicate to the seller the marketing standards for the mussels if, in Germany, the Convention's default standards were not sufficient. If the buyer has no knowledge of his country's standards, which he could easily obtain, it is not fair to expect such knowledge from a foreign seller. The test of 'what a reasonable person of the same kind in the same circumstances as the seller would have had (or known)' about the marketing standards in the buyer's country is relevant to determine

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<sup>41</sup> Karollus (n 9) 67.

<sup>42</sup> Article 35(2)(a) CISG (n 12) prescribes ordinary use as quality standard. Goods are unfit for ordinary use when they lack specific ordinary characteristics or when they have defects impeding their material use. Goods are also unfit for ordinary use when the defects considerably lessen their trade value. Bianca (n 9) 274; in agreement Enderlein and Maskow (n 9) 144; The goods must not be much below the standard that can reasonably be expected according to the price and other circumstances, Bianca (n 9) 281; Enderlein and Maskow (n 9) 144.

whether the breaching seller is guilty for lacking such knowledge.<sup>43</sup> Protecting the buyer's contractual expectations should not assume the seller's responsibility to deliver goods conforming to the marketing requirements in Germany even though the Swiss seller knew that the buyer had intended to trade the goods therein, unless a reasonable seller of the same kind in the same situation would have known these marketing requirements in Germany. Therefore, it would be prudent for buyers to include a cancellation clause in their transactions which provides that the seller assumes full responsibility should the goods fail to pass health inspections or other local requirements such as safety tests and technical standards in the import country.<sup>44</sup>

The objective interpretation above performs two policy considerations that presumably promote the CISG's general principles. First, as referred to in *New Zealand Mussels*, ignoring local regulations ensures that the Convention is interpreted in a unified fashion. The second and more relevant one is that the function of foreseeability is in place to allocate to the prospective aggrieved party a duty to provide the other party with information if they have idiosyncratic interests in the performance being a certain way when such interests could not be readily assumed.<sup>45</sup> Thus, the objective interpretation reduces the risk that the buyer may intentionally hide his essential interests of specific performance in general terms in order to either (1) burden the seller with additional costs after concluding the contract,<sup>46</sup> or (2) allow himself an easy exit from the contract by alleging uncommon interests that the seller should have foreseen.

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<sup>43</sup> Article 8(2) CISG (n 12).

<sup>44</sup> See *Frozen Stockfish Case* Appellate Court Pontevedra, Spain (3 October 2002); Enderlein and Maskow (n 9) 145.

<sup>45</sup> It is recommended the buyer makes his purpose known to the seller. See Bianca (n 9) 275; Enderlein and Maskow (n 9) 145.

<sup>46</sup> Because it is generally assumed that the goods of higher quality incur higher cost.

Certainly, these considerations make sense where the seller acts professionally and in good faith. In certain circumstances, there are good reasons to rule otherwise and to count conformity according to the buyer's country standards. The need for trust in an international sales contract is definitely an aspect of the CISG if it has not already been agreed to be one of its underlying general principles. The trust aspect has been conceptualised under CISG in that the international buyer is entitled to expect the goods to possess particular qualities, not just ordinary qualities, even if the contract does not expressly state this. Article 35(2)(b) allows the buyer to reasonably rely on the seller's skill and judgment to deliver conforming goods of a particular quality that fit the intended special use despite the absence of an express contractual agreement.<sup>47</sup> Indeed, it would seem that an obligation to deliver goods conforming to the buyer's country standard is to be implied in cases where the buyer reasonably trusted the seller to undertake such an obligation.

In addressing this issue, the BGH held that the New Zealand mussels were in conformity as they were fit for 'ordinary' (resale) purposes notwithstanding that they were not fit for the buyer's particular purpose. It was not reasonable for the German buyer to rely on the Swiss seller's skill and judgment to deliver goods fit for resale in Germany without informing the seller about the special marketing standards in Germany. It is, however, a central policy consideration to protect the buyer where the seller's performance was contrary to the reasonable reliance of the trusting buyer. Within the context of *New Zealand Mussels*, the BGH acknowledged three exceptions: (1) an obligation as to fitness for special intended purpose would be implied where the public laws and regulations of the buyer's state were identical to those enforced in the seller's state; (2) the buyer reasonably relied on the seller's expert knowledge to follow these regulations; and (3) the seller had knowledge of such

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<sup>47</sup> In addition to Article 35(2)(b), the need for a trust aspect features under the Convention in Articles 16(b) CISG (n 12); the revocation of the offer may have no legal effect if it was reasonable to the offeree to act in reliance of such offer.

regulations due to special circumstances. The ‘special circumstances’ can be interpreted widely to include a number of examples, such as an unauthorized manipulation of the goods by the seller; or where there was a previous business relationship between the parties; or where the seller had a branch or office in the buyer’s country which made him aware of the local standards. In all these situations the actual or presumed knowledge of the seller is sufficient to establish his responsibility for fundamental breach. The buyer’s reasonable reliance on the seller’s skill and judgment to provide goods conforming to the local marketing requirements was protected in the provided cases of the second group above.

### **7.2.3 Conclusion**

The Convention has no direct rules on the issue of compliance of the goods with the domestic marketing standards of the buyer’s country. This issue was examined closely in the *New Zealand Mussels* case before the BGH. There is a general rule and some exceptions. The non-conformity of the goods with the buyer’s marketing standards does not constitute fundamental breach unless the buyer has reasonably relied on the seller’s skill and judgment to provide goods conforming to these standards. The buyer may reasonably rely on the seller’s skill and judgment if the seller had knowledge or should have had knowledge of such regulations if he acts professionally and in good faith.

### **7.3 Fitness of the goods for an ordinary purpose: The reasonable use rule**

Under Article 35 CISG, the seller must deliver goods that are of the quantity, quality and description required by the contract and which are contained or packaged in the manner required by the contract. Where the contract does not specify these conditions, the standards in Article 35(2) CISG become relevant. The application of Article 35(2) CISG is controversial in the legal literature, specifically, whether this requires generic goods to be of

average quality or whether merely ‘marketable’ goods are sufficient.<sup>48</sup> Several German and Swiss courts affirmed the rule that there is no fundamental non-conformity if it is reasonable for the buyer to make some other use of the non-conforming goods and invoke different remedies, such as reduction of price or damages in order to compensate for the defects. A fundamental non-conformity will exist if the goods cannot reasonably be used for the intended purpose for which they were bought.

Where a buyer makes his purpose for the goods known to the seller there is ‘an implied condition that the goods shall be reasonably fit for such purpose’.<sup>49</sup> The decisive factor is whether the goods are totally unsuitable for the use intended by the buyer to the extent that the buyer’s interest in the fulfilment of the contract ceases to exist as a consequence of non-conformity.<sup>50</sup> The exact purpose of the contract, ie whether the goods were bought for resale, retail or processing, may be a good benchmark for determining a different treatment.

### **7.3.1 Application of reasonable use rule where goods are bought for resale purpose**

If the goods were bought for resale, there will be no fundamental breach if the buyer can resell the goods, albeit for a lower price, and he can claim damages for the losses incurred. A fundamental breach will exist only if the non-conforming goods cannot be resold at all. The leading decision on this is the *Cobalt-Sulphate* case,<sup>51</sup> handed down by the Federal Supreme Court of Germany. The seller had delivered to a German buyer various quantities of cobalt sulphate that had originated in South Africa. However, it had been agreed that the goods would be of British origin. The buyer tried to avoid the contract on several grounds, one of which was by alleging serious difficulties in exporting the goods to India and South East Asia

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<sup>48</sup> Schwenger (n 5) para 61, 577.

<sup>49</sup> Schwenger (n 29) 795, 801.

<sup>50</sup> Peter Huber, ‘Remedies of the buyer’ in Peter Huber and Alastair Mullis, *The CISG: A new textbook for students and practitioners* (Sellier 2007) 228.

<sup>51</sup> *Cobalt Sulphate Case* Supreme Court Germany (3 April 1996); Huber (n 50) 228-29.

where an embargo on South African products was in place. The Court held that there was no fundamental breach of contract since the buyer failed to prove his established business in the prohibiting countries or to prove difficulties in trading the goods in Germany or abroad in exporting them to another country. Thus, the buyer failed to show that he was substantially deprived of what he was entitled to expect under the contract.<sup>52</sup> This decision can be taken as an example of the severity of the fundamental breach test, which is that the breach is not fundamental as long as the goods are still, at least, tradable abroad. However, such an interpretation is not convincing.

The reasonable use rule is regularly found in case law which relates to the quality of non-conforming goods. In a case which involved the supply of women's shoes by an Italian seller to a German buyer, the delivered shoes were not in conformity with the sample or model presented at the conclusion of the contract. The buyer complained that the shoes were made of the material 'S Oro' instead of 'Metallic Leather Gold' and this caused the shoes to have heavy wrinkles. Some of the shoes were 'stitched', others had been 'folded up'. The court granted the buyer the possibility of substantiating the unacceptability of any further use but supplementary allegations were not presented. The court stated that the buyer did not succeed in showing that 'the delivered shoes have been predominantly non-conforming'. Consequently, the court held that the buyer was not entitled to declare the contract avoided and refuse to pay the purchase price because he had failed to establish that a fundamental breach of contract had occurred, as set out in Articles 49(1) and 81(1) CISG. The court noted that the buyer did not specify whether the shoes were just below standard in which case the buyer could, for example, reduce the price or claim damages, or whether they were totally

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<sup>52</sup> Huber (n 50) 228-29; Mullis (n 29) 340.

unfit for resale in which case the buyer could declare the contract avoided.<sup>53</sup> In commentary on this case, one author, despite his agreement with the court findings, raises the question of how a buyer can convince the court that the goods are not saleable. The suggested answer is that it should be sufficient for the buyer to specify the non-conformity and the reasons why it is likely that the goods will not be saleable. The buyer should not be forced to wait until his customers reject the goods. From this perspective, the requirements to prove the goods to be unfit for resale, as stated by the respective court, seem too severe.<sup>54</sup>

There are further examples where the courts ruled in favour of maintaining the contract where the non-conforming goods were not totally unsuitable for their ordinary purpose. Where a buyer explicitly ordered unsweetened apple juice concentrate and the seller delivered sweetened apple juice mixed with glucose syrup, the buyer would still not be entitled to declare the contract avoided. In that case, the buyer pleaded that his customers had been unable to trade the goods as apple juice concentrate because the drinks actually produced from it, in contrast to 'apple juice', could contain sugar additives. This fact, ie producing sweetened juice, was decisive for the court to decide in this case that the *aliud* delivery did not constitute fundamental breach because the goods were used for the production of apple fruit drinks after all. The court held that the buyer was entitled to reduce the price as the goods delivered were of lesser value than apple juice concentrate.<sup>55</sup> A similar example can be drawn from the Swiss jurisdiction. The delivery of frozen meat that was too fatty and too wet resulted in a 25.5 per cent decrease in its value. The Swiss Supreme Court confirmed the

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<sup>53</sup> The court also rejected the buyer's claim to avoid the contract on the ground of late delivery as he failed to comply with the *Nachfrist* procedures; *Shoes Case* Appellate Court Frankfurt, Germany (18 January 1994).

<sup>54</sup> Karollus (n 9) 64.

<sup>55</sup> *Apple Juice Concentrate Case* Appellate Court Stuttgart, Germany (12 March 2001).

lower court's finding that the buyer was not entitled to avoid the contract because he had had the ability to process the goods or to sell them, even though it was at a lower price.<sup>56</sup>

Therefore, the conclusion is that if a buyer is able to use defective goods that he bought for resale or processing in any way then, as a general rule, one cannot assume a fundamental breach of contract.<sup>57</sup>

### **7.3.2 Restrictions of the reasonable use rule**

Whether disputed goods that are not in conformity can still reasonably be used is a matter of facts rather than a legal issue.<sup>58</sup> Thus, the court may make its judgment on whether the non-conformity is fundamental or whether the defective goods are still usable by reference to the experts' opinion in the business concerned.<sup>59</sup> The mere fact that the goods are resalable by the buyer or can somehow be used does not always preclude the existence of a fundamental breach. For instance, if the buyer is a wholesaler with broader access to markets, it would be reasonable to expect him to use part of his facilities for the sale of low-quality goods at discounted prices.<sup>60</sup> This is in contrast to a retailer who runs an exclusive boutique and has a specific target group of customers, where low-quality goods would have no place in his upmarket showroom.<sup>61</sup> Therefore, there are some restrictions that mitigate the severity of the reasonable use rule. It has also been submitted that the goods must be fit for the purposes for which goods of the same description would ordinarily be used or for any particular purpose made known to the seller. Furthermore, the goods must be of average quality and it does not

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<sup>56</sup> *Meat Case* Supreme Court Switzerland (28 October 1998).

<sup>57</sup> *ibid*; *Globes Case* District Court München, Germany (27 February 2002); Chengwei Liu, 'The Concept of Fundamental Breach: Perspectives from the CISG, UNIDROIT Principles and PECL and case law' (2nd edition, May 2005) n 5.3b.

<sup>58</sup> *Banks Hardwoods Florida LLC v Iglesias SA* Federal District Court Florida, United States (29 October 2009) Plaintiff's Motion for Summary Judgment.

<sup>59</sup> *Model Locomotives Case* District Court Schaffhausen Switzerland (27 January 2004).

<sup>60</sup> Schwenzer (n 29) 802; Markus Muller-Chen, 'Article 46' in *Schlechtriem and Schwenzer* (n 5) para 25, 713.

<sup>61</sup> CISG Advisory Council (n 7).



suffice that they are only fit to be traded.<sup>62</sup> The other factors admitted to the equation by several decisions are resale in the usual course of business, the danger of the loss of customers, and the particular purpose for which the goods were bought. That is, the buyer proves that he has essentially lost what he was entitled to expect under the contract.

### **7.3.2.1 Resale in usual course of business**

It would be more accurate to understand the reasonable use rule, in the cases outlined above, if followed by the addition of *in the usual course of business*. The fact is that all non-conforming goods, whatever their value, can always be used again, if not in the same form then at least they can be sold to the recycling industry or even sold abroad. However, in several decisions the court affirmed fundamental breach of non-conformity without reference to the possibilities of resale abroad or for recycling purposes.<sup>63</sup> In *the Packaging Machine* case,<sup>64</sup> where the goods were bought for a particular purpose, it was stated that, with respect to the question of whether the buyer can still be expected to resell or use the non-conforming goods, it must be taken into account whether the buyer is a professional reseller (trader), manufacturer or final customer of the respective type of goods. Generally, it will not be appropriate for a manufacturer or final customer to use or resell goods of inferior quality if he is not at all engaged in trading the individual components or materials.

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<sup>62</sup> *Shoes Case* District Court Berlin, Germany (15 September 1994) affirming the *Shoes Case* Lower Court Charlottenburg, Germany (4 May 1994). In this case, the buyer maintains that the shoes under item nos. ... were defective and non-sellable. As far as items ... are concerned, the jewellery ornamentation elements on the front part of the shoes were not straight and the straps of items ... were too long on the inside as well as on the outside so the shoes were going baggy easily. Further, the sole was not fixed properly, and the straps on heels were backstitched too narrowly. The seller maintains that the delivered shoes were in accordance with the sample on the basis of which the shoes were ordered. The court considered this argument as irrelevant because the seller never alleged that the parties actually agreed to be bound by the sample, nor he proves that the sample also had the same defects alleged by the buyer.

<sup>63</sup> See for example the case of sugared wine at the French court mentioned earlier or sports clothing case.

<sup>64</sup> *Packaging Machine Case* Bundesgericht Federal Supreme Court Switzerland (18 May 2009).

To deny fundamental breach of contract when the seller delivers reasonably usable goods albeit non-conforming ones would result in the buyer paying for unwanted goods with limited opportunities of getting back what he originally contracted for. Such a result would certainly agitate the contractual foundations of international sales in the long-term and the buyers would soon start to opt out of the CISG for their future transactions. The restrictive condition ‘in the usual course of business’ would mitigate the undesired application of the reasonable use rule.

### **7.3.2.2 Customer loss**

The customer loss restriction on the reasonable use rule can be drawn from a number of court decisions. When the buyer runs a small resale shop, the resale of defective goods may easily lead to a general loss of trust in the buyer’s reputation among his customers.<sup>65</sup> It has also been held that a delivery which led to thirty six complaints from a buyer’s customers constitutes a fundamental breach of contract by the seller.<sup>66</sup> Another example can be drawn from *the Sport Clothing case*.<sup>67</sup> In this case, a Swiss buyer and a German seller concluded a contract for the sale of sporting clothes. After delivery, the buyer complained that a number of items ordered were missing, that others were of the wrong colour and that the clothes shrank excessively after washing. The buyer therefore declared the contract avoided and asked the seller to refund the price paid and take back the goods. When the seller failed to comply, the buyer commenced legal action. The Court held that the buyer was entitled to declare the contract avoided due to the seller’s fundamental breach, particularly ‘by delivering clothes that shrank about 10-15%’. The court emphasized that the buyer would suffer considerable detriment

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<sup>65</sup> Carlo Mastellone, ‘The Right to Avoid the Contract: The Concept of “Fundamental Breach” Under the CISG’ (International Sale of Goods Commission, 55th UIA Congress Miami, Florida, United States, 31 October-4 November 2011) ‘The Impact of the Uniform Sales Law on Drafting the Contract for International Sale’.

<sup>66</sup> *Shoes Case* Appellate Court Koblenz, Germany (21 November 2007).

<sup>67</sup> *Sport Clothing Case* District Court Landshut, Germany (5 April 1995).

since the buyer's customers either would have returned the merchandise or would not have bought any more merchandise from the buyer.<sup>68</sup>

Unless otherwise agreed, the reasonable use test provides an aid for detecting fundamental breach in cases of non-conformity of the goods. In general, the breach would not be fundamental if the buyer is still able to use non-conforming goods in the usual course of his business without losing his customers.

#### **7.4 Fitness of the goods for particular purpose: Application of strict compliance rule**

##### **7.4.1 Fitness of the goods for particular purpose**

There are decisions that have affirmed non-conformity as a fundamental breach without referencing the reasonable use rule. In *Delchi Carrier SpA v Rotorex Corp*,<sup>69</sup> the defendant, a Maryland manufacturer of compressors for air conditioners, agreed to sell to the plaintiff, an Italian manufacturer and seller of air conditioners, 10,800 compressors that were to be delivered in three instalments. The buyer, apparently at the time of the contract, informed the seller that the compressors would be used in the production of its *Ariele* line of air conditioners, a product that the buyer expected to sell some months later. The seller sent a first shipment of compressors and received the related payment. While the second shipment was in transit, the buyer discovered that the delivered compressors did not comply with the contractual specifications regarding cooling capacity and power consumption, and so rejected the compressors and cancelled the contract. The Court confirmed that Rotorex, the seller, was liable for a fundamental breach of contract under the Convention because 'the cooling power and energy consumption of an air conditioner compressor are important determinants of the product's value', and granted the buyer damages. The court did not take into account whether

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<sup>68</sup> A different view of the *ratio decidendi* of this case has been submitted by Robert Koch. He believes that the courts were focusing on the monetary loss suffered by the aggrieved party in relation to the contract's overall value for the determination of fundamental breach; Koch (n 4) 238.

<sup>69</sup> *Delchi Carrier v Rotorex* Federal Appellate Court (2<sup>nd</sup> Circuit) United States (6 December 1995).

the buyer could have reasonably be expected to resell the defective goods or make any other use of them and claim damages or price reduction. In this particular case, there was no room for the court to address the reasonable use criterion.<sup>70</sup> It has been submitted that there were no other reasonable uses to which the defective compressors could have been put in the usual course of the buyer's business. The wording of the summary judgment of the District Court supports this analysis of the Court's position. The Court held that:

There appears to be no question that [Delchi] did not substantially receive that which [it] was entitled to expect and that any reasonable person could foresee that shipping nonconforming goods to a buyer would result in the buyer not receiving that which he expected and was entitled to receive.<sup>71</sup>

In another case, which involved the sale of roll aluminium and aluminium parts for the manufacture of cans,<sup>72</sup> the contract called for roll aluminium of 0.0125 +/- 0.0001 inches. The deviation in thickness of the delivered roll of 0.0007 inches less than the thickness specifications was held to be a fundamental breach that resulted in the buyer's end user, the Mu Danjiang Material Beverage Can Factory, being unable to use the rolls for the production of the can bodies. In this case, however, the buyer had informed the seller before the contract was concluded that the quality of the roll aluminium and its thickness were very important in performance because if the aluminium roll did not meet the specifications then the buyer's end user could not use it in its factory.

In *Steel Rods*,<sup>73</sup> which concerned a dispute over non-conformity of billets or steel rods to manufacture axle spindles, the court considered in detail the object of the sales contract and the use for which the purchased goods had been intended in order to determine whether the

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<sup>70</sup> Peter Huber, 'Typically German?: Two Contentious German Contributions to the CISG' (2011) 3 *Belgrade Law Review* 150, 27. See also a different analysis of this case based on economic criteria by Koch (n 4) 239; However, the wording of the decision did not support such an economic approach.

<sup>71</sup> *Delchi Carrier v Rotorex* (n 69).

<sup>72</sup> *Roll Aluminium And Aluminium Parts Case* CIETAC Arbitration Proceeding, China (30 October 1991).

<sup>73</sup> *Steel Rods Case* Provincial High Court Navarra, Spain (30 July 2010).

non-conformity was fundamental. The court also followed the analysis of the expert testimony which considered that the billets supplied clearly had faults which rendered them unfit for their intended use, especially given that faults were not acceptable in the automotive sector and that it had been proved that the lack of conformity stemmed from the raw materials supplied.<sup>74</sup>

In the *Hammer Mill* case<sup>75</sup> it was held that the delivery of goods (hammer heads) which are a critical part of a device (a mill) and that weighed over 10% more than what was specified in the contract was a fundamental breach.

It can be established from the above that where the goods were bought for a particular purpose then a strict compliance duty with the contract specifications may be assumed unless agreed otherwise.

#### **7.4.2 Conditions for application of the rule of strict compliance**

There are two conditions to conclude a strict compliance duty if the goods were bought for a particular purpose: knowledge of the seller, and reasonable reliance of the buyer.

##### **7.4.2.1 Knowledge of the seller**

The seller must know the particular purpose of the goods by the time of the conclusion of the contract so that the seller can refuse to enter the contract if he is unable to furnish goods adequate for that purpose. The buyer must show that the seller knew of that particular

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<sup>74</sup> A similar conclusion was held in other cases: *Case On Apparatus For The Reduction Of Consumption Of Gasoline* Appellate Court Castellón, Spain (21 March 2006); *Automobile Case* CIETAC Arbitration Proceeding, China (December 2006); *Water Pump Case* CIETAC Arbitration Proceeding, China (3 August 2006).

<sup>75</sup> *Hammer Mill Case* CIETAC Arbitration Proceeding, China (May 2007).

purpose at the time of the conclusion of the contract and that the goods were unfit for that purpose.<sup>76</sup>

#### **7.4.2.2 Reasonable reliance of the buyer**

The seller must strictly comply with the contractual specifications unless the circumstances show that the buyer did not rely on, or that it was unreasonable for him to rely on, the seller's skill and judgement.<sup>77</sup> The seller has the burden of proving that the buyer did not rely on or that it was unreasonable for him to rely on the seller's skills and judgement. The circumstances in which the buyer may not rely on the seller's skill and judgement must be ascertained on a case by case basis. If the seller makes known to the buyer that the goods ordered by the buyer would not be satisfactory for the particular purpose for which they have been ordered and the buyer still wishes to order the goods, the buyer cannot claim that he relied on the seller's skill and judgement. Generally, it can be said that it would be unreasonable for the buyer to rely on the seller's skill and judgement if the seller did not purport to have any special knowledge in respect of the goods in question or if a skill and judgement capacity is not common in the seller's trade branch.<sup>78</sup>

#### **7.5 Non-conformity with a sample or model**

Article 35(2)(c) considers that goods do not conform to the contract unless they possess the qualities of goods which the seller has held out to the buyer as a sample or model. This situation must be distinguished from two similar situations: the first, where the parties have expressly agreed on strict compliance in performance (as in a particular purpose of the

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<sup>76</sup> Honnold (n 9) 258.

<sup>77</sup> Article 35(b) CISG (n 12); Sanna Kuoppala, 'The Application and Interpretation of the CISG in Finnish Case Law 1997-2005' (Licentiate Thesis, University of Turku April 2009) para 6.4.2.

<sup>78</sup> Text of Secretariat Commentary on Article 33 of the 1978 Draft (draft counterpart of CISG Article 35) United Nations, 'Commentary on the Draft Convention on Contracts for the International Sale of Goods prepared by the Secretariat' UN Doc A/CONF.97/5; Bianca (n 9) 275-278; Kuoppala (n 77) para 6.4.2.

goods); and the second, where the law assumes the qualities of a sample or model to be treated as a contractually promised quality in the sense of the rule that can be found in Section 2-313(1)(c) UCC, Section 15 of the English Sale of Goods Act (1893) or Section 494 of the former BGB.<sup>79</sup> Interpreting the phrase ‘possess the qualities’ in Article 35(2)(c) CISG would not seem enough to imply a strict compliance duty. In addition, there is no clear legislative intention to borrow the technique of implied conditions from any domestic system and use it in this Article.

The result of such a distinction is that not every failure to provide goods conforming to the sample or model justifies avoidance of the contract. The implied terms in Article 35(2) CISG cannot be applied in the same way as the conditions under the English Sale of Goods Act. The test here is whether the buyer has essentially obtained, albeit in a defective state, the goods he intended to receive. If a buyer is able to use the defective goods in any way, one cannot assume a fundamental breach of contract.<sup>80</sup> Furthermore, even if the buyer entirely lost what he was entitled to expect under the contract, the seller may still be entitled to a defence in order to challenge his avoidance.<sup>81</sup>

### 7.5.1 Sample cases

In a case that involved sales of skin care products, the Helsinki Court of Appeal affirmed fundamental non-conformity because the goods did not possess qualities that the seller had held out to the buyer.<sup>82</sup> The VTT’s (the test of the National Scientific Research Centre) results, received in October 1992, highlighted that the vitamin [A] content had decreased

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<sup>79</sup> For the opposite view see: Peter Schlechtriem, ‘The Seller’s Obligation Under the United Nation Convention on Contract for the International Sale of Goods’ in Nina Galston and Hans Smit (eds), *International sales: The United Nations Convention on Contracts for the International Sale of Goods* (Matthew Bender 1984) chapter 6, 6-22.

<sup>80</sup> *Globes Case* (n 57).

<sup>81</sup> Such as the seller’s non-foreseeability of the result or the buyer’s actual or supposed knowledge of the defects.

<sup>82</sup> *Skin Care Products Case* Helsinki Court of Appeal Finland (30 June 1998).

significantly below the lowest level agreed. Had the seller stated that '[s]helf-life of our products is not shorter than 30 months', the Finnish buyer have refused to accept further delivery and declared the contract avoided for the delivery that had already had been made. The seller argued that avoidance of the contract was unfounded for several reasons. Firstly, the goods subject to cancellation were in conformity with the sample goods checked and accepted at VTT in April 1992 at the time of contract. Secondly, there was no agreement between the seller and the buyer that the vitamin A content in the skin care products should be permanent in nature. The buyer knew, and it is generally known in the field of skin care products, that vitamins, perfumes and some other ingredients are in a constant process of transformation and decomposition. The seller explained the term 'shelf-life' to mean that the product would be preserved when duly kept in normal or reasonably anticipated circumstances and that the product fulfilled its original purpose without causing any danger to health. According to the seller, giving the shelf-life did not equate to giving a guarantee that the vitamin content would be preserved throughout the said period. Thirdly, the seller was not liable for alleged non-conformity of the goods of which the buyer was aware when drafting the contract.

There were several issues before the court. One of these was how to interpret the contract, in particular, the exact meaning of shelf-life. Another issue was to find out whether the seller could benefit from Article 35(3) CISG due to the buyer's general knowledge about the nature of the product or whether the buyer was entitled to rely on the seller's skills and judgment.

On the basis of expert statements<sup>83</sup> and because the seller had not presented sufficient evidence to the contrary, the Court of First Instance held that the seller had given a guarantee

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<sup>83</sup> No evidence has been submitted concerning the content of the notion of 'shelf-life' under Swiss law or practice. As a witness to the seller, [M], a German citizen, gave his view on the content of the notion in Switzerland, that during the announced shelf life the product may not change in terms of its preservation or qualities. During further questioning, [M] submitted that a product meets the shelf-life requirement if it is



that the essential qualities would be maintained at least throughout the month shelf-life of the product. The declaration given by the seller concerning the thirty month shelf-life of the product also related to the vitamin A content because the level of vitamin A was considered a central quality of the goods sold. Thus, the seller's breach of contract clearly fulfilled the conditions for fundamental breach of contract as defined in Article 25 CISG.

Furthermore, the fact that vitamin A decomposes over time, which was known by the buyer and was also generally known in the field, bears no significance to this case. Based on the seller's assurances that he was able to reach the required levels of vitamin content, it was not the business of the buyer to find out how the seller would seek to achieve this. This being the case, it appears that the buyer counted on the seller's expertise in terms of how the seller reached the required vitamin A content and how the required preservation was carried out. Therefore, the buyer was entitled to declare the contract avoided. The seller had renewed his claims to the Court of Appeal; the latter held that there were no reasons to change the judgement of the Court of First Instance.<sup>84</sup>

In the *Packaging Machine* case<sup>85</sup> the buyer asserted that the seller had promised an output of one hundred and eighty vials per minute while the actual performance of the machine was fifty-two vials per minute although a maximum velocity of one hundred and fifteen vials per minute was also possible. The seller argued that overall performance of one hundred and

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suitable for its original purpose even when it is supposed to contain an undetermined amount of vitamins. Witness [M] stated as his understanding that what is meant by shelf life is the time that all the central qualities of the product are preserved and the announcement of which is based on tests carried out by the manufacturer. Witness [A] is responsible for the product development of L Oy and he must have been aware of the international content of the shelf-life concept. [A] stated, as to his understanding, that announcing the time the product is preserved concerns physical, microbiological and chemical preservation. The products with vitamin content are more expensive than regular skin care products. Consequently, according to [A], announcing the shelf-life as being at least thirty months has also meant that the product maintains its vitamin [A] content at least for the duration of the shelf-life of the product. Furthermore, [A] stated that it is typical for the trade that shelf-life announcement of cosmetics concerns all the qualities of the products. [A]'s statement was supported by statements of other witnesses [N] and [R].

<sup>84</sup> *Skin Care Products Case* (n 82).

<sup>85</sup> *Packaging Machine Case* (n 64).

eighty vials per minute was neither possible nor had it ever been agreed upon by the parties. The buyer declared avoidance of contract and sued for damages. The court considered the qualities of the machines that were held by the seller to draw its findings on whether the non-conformity was fundamental. The court found the actual output of fifty-two vials per minute was equivalent to a loss of production of 71% in comparison with one hundred and eighty vials per minute as had been agreed in the contract. Even if the existence of a breach of contract were to be determined by reference to the maximum performance of one hundred and fifteen vials per minute, the loss of production would still amount to 40% as a result of extended downtimes. The Appellate Court confirmed the reasoning of the District Court. This decision appears to be convincing given that a mere price reduction could not be considered because the buyer's loss of productivity throughout the expected lifetime of the machine would exceed the purchase price by far.<sup>86</sup>

### **7.5.2 Drawing the fundamental breach criterion**

In the *Skin care* case, the seller failed to deliver goods that were of the quality and description required by the contract. From the facts above it appears that the goods still possessed the merchantable qualities associated with skin care products. However, the court did not discuss whether the non-conforming goods were worthless or were still saleable in the normal course of the buyer's business. It is highly unlikely that the court could have concluded a strict compliance agreement in defining fundamental breach because the seller had denied that there was any unequivocal agreement with the buyer to maintain the vitamin A content. The *ratio decidendi* of this case, however, leads one to believe that the seller's statement about the shelf life of the products was essential in the court deducing fundamental non-conformity.

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<sup>86</sup> On assumption that: 8-hour shifts and downtimes extended by the factor 1.5; See: Carlo Mastellone, 'The Right To Avoid The Contract: The Concept Of "Fundamental Breach" Under The CISG' 55th UIA Congress Miami, Florida (United States) October 31 –November 4, 2011 International Sale Of Goods Commission Date Of The Session: Thursday November 3, 2011.

This statement made it reasonable for the buyer to rely on the seller's skills and judgment to provide conforming goods.<sup>87</sup>

A similar conclusion can be drawn from the *Packaging Machine* case.<sup>88</sup> The statement of the seller made it reasonable for the buyer to rely on the seller's skills and judgment to provide conforming goods, thus establishing the responsibility of the seller upon failure to deliver conforming goods.

## **7.6 Other cases of non-conformity**

The other cases of non-conformity are those with defects in quantity and packaging.

### **7.6.1 Defects in quantity**

Failure by the seller to deliver the contractual quantity, whether more or less than that agreed, constitutes a lack of conformity for the purpose of Article 35(1).<sup>89</sup> However, it has been suggested that the deviation between the quantity of the goods in contract and the quantity of the goods actually delivered can be seen as partial delivery or rather as non-conformity.<sup>90</sup> The different views on this issue seem of no importance to the question of avoidance of contract when the discrepancy in quantity amounts to fundamental breach. The provisions of avoidance for partial delivery are *lex specialis* and these derogate from *the lex generalis* of non-conformity provisions. However, the duty to examine the goods and to give notice as required in Articles 38 and 39 CISG would still be essential for the buyer in order to retain its

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<sup>87</sup> For different view establishing the courts' finding on the strict compliance requirement see Sanna Kuoppala, "The Application and Interpretation of the CISG in Finnish Case Law 1997-2005" (April 2009) (at n. 6.4.6.2)

<sup>88</sup> *Packaging Machine Case* (n 64).

<sup>89</sup> Schwenzer (n 5) para 8, 572.

<sup>90</sup> See the controversial dissection of this issue in Benjamin K Leisinger, *Fundamental Breach Considering Non-Conformity of the Goods* (Sellier 2007) 9-10.

other non-avoidance remedies if the shortfall in delivered quantity has to be considered as a non-conforming delivery.<sup>91</sup>

There are several provisions in the CISG that deal with the issue of partial delivery. The general rule is that if the seller delivers part of the goods or if only part of the goods delivered is in conformity with the contract, the buyer will have the same remedies with respect to the undelivered or non-conforming goods as he has with respect to the entire quantity of the goods. In other words, the buyer can treat the missing or non-conforming goods as the subject of a contract that is severable for remedy purposes. This rule is applicable to deliveries under both single-delivery and instalment contracts.<sup>92</sup> For example, the buyer may have the right to partial avoidance as to the faulty portion of the delivery, thus eliminating his obligation to pay for the missing or defective goods and entitling him to the market price for damages for these.<sup>93</sup> However, the buyer is only entitled to avoid the contract in its entirety if the seller's breach amounts to a fundamental breach of the whole contract.<sup>94</sup>

The question of when the partial delivery represents a fundamental breach of the whole contract is a matter of contract interpretation. It may depend on the importance that the buyer attaches to full delivery as expressed in the contractual terms or it may be inferred from the nature of the goods sold, for example, whether the goods are indivisible,<sup>95</sup> or it may result from the fact that only a small amount of delivered goods are in conformity.<sup>96</sup> Generally speaking, the failure to deliver a large portion of the goods is considered a fundamental

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<sup>91</sup> *Acrylic Blankets Case* Appellate Court Koblenz, Germany (31 January 1997); *Tinned Cucumbers Case* Appellate Court Düsseldorf, Germany (8 January 1993); Leisinger (n 90) 9-10.

<sup>92</sup> See Articles 35(1), 51(2) CISG (n 12) for single delivery; see Article 73 CISG for instalment contract.

<sup>93</sup> Harry M Flechtner, 'Remedies under the New International Sales Convention: The Perspective from Article 2 of the UCC' *Journal of Law and Commerce* (1988) 53.

<sup>94</sup> Jacob S Ziegel, 'Report to the Uniform Law Conference of Canada on Convention on Contracts for the International Sale of Goods' (July 1981) <<http://www.cisg.law.pace.edu/cisg/text/ziegel51.html>> accessed 22 June 2014.

<sup>95</sup> Schroeter (n 34) para 42, 421.

<sup>96</sup> If only 20% of the amount ordered is delivered free of defects, there is a fundamental breach of contract; see Schroeter (n 34) note 174, 421.

breach. A few examples may provide a better understanding about when partial delivery is fundamental. In a liquor sales contract, the Shanghai First Intermediate People's Court decided that the delivery of only a small percentage of the goods, none of which included the brands listed in the sales contract, constituted a fundamental breach.<sup>97</sup> An American court considered 93% of delivered goods which performed below the cooling capacity that was usual for air conditioners to be a fundamental breach.<sup>98</sup> In a French case, 380 non-conforming motherboards out of 445 were sufficient to avoid the entire contract.<sup>99</sup> The *Tribunale di Forli* decided that the buyer was entitled to avoid the contract if the number of non-conforming goods was more than 90%.<sup>100</sup>

However, it cannot be said that a minor deviation in quantity should not constitute fundamental breach even though it can be noted that the Australian proposal to that effect was rejected at the Vienna Conference.<sup>101</sup> In case law, a German court found that 420 kg of non-conforming goods out of 22 tons was sufficient for avoidance. Therefore, the courts and tribunals should not be tempted to excuse minimum quantity defects as not fundamental. One of the reasons given for refusing to allow the buyer to avoid the whole contract because of short delivery was that 'the purpose of the contract could still be fulfilled by the buyer obtaining substitute goods elsewhere'.<sup>102</sup> However, it is suggested that this is an unfortunate

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<sup>97</sup> *Shanghai Anlili International Trading Co Ltd v J and P Golden Wings Corp* Shanghai First Intermediate People's Court, China (25 December 2008).

<sup>98</sup> *Delchi Carrier v Rotorex* (n 69).

<sup>99</sup> *Computer Motherboard Case* Appellate Court Paris, France (7 October 2009).

<sup>100</sup> *Mitias v Solidea Srl* Tribunale di Forli (District Court) Italy (11 December 2008); Markus Müller-Chen and Lara M Pair, 'Part II: International Sales Law Commercial Law, Chapter 35: Avoidance for Non-conformity of Goods under Art. 49(1)(a) CISG' in Stefan Michael Kröll and others (eds), *International Arbitration and International Commercial Law: Synergy, Convergence and Evolution* (Kluwer Law International 2011) 666-667.

<sup>101</sup> Schlechtriem (n 79) chapter 6, 6-22.

<sup>102</sup> *Computer Components Case* District Court Heidelberg, Germany (3 July 1992); *Fabrics Case* Appellate Court Düsseldorf, Germany (10 February 1994) 6 U 119/93.

conclusion in that it appears to place the responsibility on the buyer to cure the defects in quantity.<sup>103</sup>

### **7.6.2 Fundamental breach and packaging**

The goods must be contained or packaged in the manner usual for the goods of the same description or, where there is no such manner, in a manner adequate to preserve and protect the goods.<sup>104</sup> If non-conforming packaging leads to the consequence that the goods cannot be resold within the buyer's course of business, fundamental breach can be assumed, in particular, in commodities string transactions where the buyer normally intended to resell the goods immediately.<sup>105</sup> Incorrect packaging may amount to a fundamental breach if it breaches the known legal requirement for correct packaging in the buyer's country or if it results in goods being spoiled.

Often, inadequate packaging causes the passing of risk rules with the result that the seller is liable even though the risk has passed to the buyer. In *Conservas La Costeña v Lanín*,<sup>106</sup> the court found that the seller, under the FOB contract, was liable for failing to supervise the delivery of the goods shipped by the Chilean supplier which arrived in a damaged condition due to improper canning and packaging.

### **7.7 The seller's right to cure and fundamental breach**

Perhaps the most troubling question for courts has been whether the breach is fundamental in situations where, after the time of the projected performance has passed, cure of such breach is possible without unreasonable delay or inconvenience for the buyer. This troublesome

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<sup>103</sup> Mullis (n 29) 354.

<sup>104</sup> Article 35(2)(d) CISG (n 12); One view suggests that the packaging obligation in Article 35(2)(d) CISG 'surely help to reduce uncertainty'. This might imply to interpret Article 35(2)(d) CISG in the sense of English condition that breach of which results in avoidance right. See Schlechtriem (n 79) chapter 6, 6-23.

<sup>105</sup> Leisinger (n 90) 132-133.

<sup>106</sup> *Conservas La Costeña v Lanin* Compromex Arbitration Proceeding Mexico (29 April 1996).

question stems from the contradictory interpretation of Articles 48 CISG and 49 CISG. The controversy here is whether the seller's right to cure according to Article 48(1) CISG would prevent the breach from being fundamental and consequently preclude the buyer's right to avoid the contract according to Article 49 CISG.

### **7.7.1 Cure prior to the time of performance**

The issue of curing defective or non-conforming documents or goods prior to the time of performance is relatively non-controversial.<sup>107</sup> These have been seen as possible areas for the application of the general principle of preservation of the contract,<sup>108</sup> ie the seller has the right to cure his performance as long as its time is not yet due. In addition, it may be argued that the buyer's refusal to allow cure prior to the time of performance is by definition a breach of good faith obligations because the buyer must enable the seller to perform his obligations. In this situation of curing defective performance before its due time, the buyer cannot declare the contract avoided unless the seller's breach amounts to fundamental anticipatory breach.<sup>109</sup>

### **7.7.2 Cure when projected performance time has passed**

On the other hand, the CISG does not permit a definite conclusion in respect to the seller's right to cure if the projected time of performance has passed. Article 48 CISG provides that the seller may, even after the date of delivery, remedy at his expense any failure to perform his obligations provided that the remedy takes place within a reasonable time and without

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<sup>107</sup> Following Article 34 sentence 2, the seller has a right to cure up to that date of delivery any lack of conformity in the documents provided that the exercise of this right does not cause the buyer unreasonable inconvenience or unreasonable expense. Article 37 CISG (n 12) provides a similar right to cure in case of defective goods. See also André Janssen and Sörren Claas Kiene in André Janssen and Olaf Meyer (eds), *CISG Methodology* (Sellier 2009) 274; Mullis (n 13) 146.

<sup>108</sup> The seller seems to have no (explicit) right to cure where a third party claims ownership of the goods (see Article 41 CISG (n 12)) or claims an infringement of patent rights or trademarks (see Article 42 CISG) although the seller could potentially cure the defect by settling the dispute with the third party. See Honnold (n 9) § 245.1; Janssen and Claas Kiene (n 107) 274.

<sup>109</sup> Jonathan Yovel, 'The Seller's Right to Cure a Failure to Perform: An Analytic Comparison of the Respective Provisions of the CISG and The PECL' 2005(1) *Nordic Journal of Commercial Law* 3.

causing unreasonable inconvenience to the buyer. However, Article 49 CISG subjects the seller's right to cure to the buyer's power to declare the contract avoided in cases of fundamental breach.<sup>110</sup> If the requirements of Article 49 CISG are met, the buyer's right to avoid the contract takes precedence over the right to cure. The controversy here is whether the possibility of cure has to be taken into account when it comes to determining whether the seller's breach was fundamental in the sense of Article 25 CISG.<sup>111</sup> There are three views that can be identified:

1. The first view sees 'an intimate relationship between cure provisions and fundamental breach'.<sup>112</sup> Most commentators agree that a breach is not fundamental as long as repair is possible within a reasonable time and without causing the aggrieved party unreasonable inconvenience or uncertainty of reimbursement by the seller.<sup>113</sup> The opening clause of Article 48(1) CISG states that it is 'subject to Article 49'. However, this does not necessarily mean that the curability of the defect must not be regarded when it comes to examining the concept of fundamental breach.<sup>114</sup> Furthermore, the purpose of Article 48(1) would be frustrated if the buyer were allowed to avoid the contract before giving the seller an opportunity to cure the defect.<sup>115</sup> Thus, a breach that can be cured in accordance with the requirements of Article 48(1) CISG will usually not be regarded as fundamental unless the seller refuses or fails to cure.<sup>116</sup>

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<sup>110</sup> Article 49 CISG (n 12).

<sup>111</sup> Huber (n 50) 217 and 221-225.

<sup>112</sup> Shinichiro Michida, 'Cancellation of Contract' (1979) 27 *American Journal of Comparative Law* 279; similarly Honnold (n 9) 320.

<sup>113</sup> M Will, 'Article 25' in Bianca and Bonell (n 9) 349; Honnold (n 9) 296; Huber (n 50) 222 and 228; Markus Müller-Chen, 'Article 48' in *Schlechtriem and Schwenzler* (n 5) para 15; Mullis (n 29) 343.

<sup>114</sup> Huber (n 50) 222.

<sup>115</sup> Honnold (n 9) 320ff.

<sup>116</sup> However, exceptions may be admitted where the buyer has a particular and legitimate interest in being allowed to avoid the contract immediately. See Huber (n 50) 223.



2. Some authors,<sup>117</sup> on the other hand, argue that ‘there is no requirement in the Convention requiring an injured party to give a breaching party an opportunity to cure before exercising the right of avoidance’.<sup>118</sup> The seller’s right to cure operates independently of the distinction between fundamental and non-fundamental breaches. An offer to cure should not be considered in determining fundamental breach. The imprecise elements, such as cure within reasonable time, unreasonable inconvenience or unreasonable uncertainty would weaken the concept of fundamental breach because these hinge the non-fundamentality of the breach on receiving a rightful offer to cure which, in its turn, would burden the buyer with the risk of evaluating the offer as either a rightful one or one based on mere expectancy. In addition, defining fundamental breach in the light of a feasible repair would render meaningless the buyer’s right to require substitute goods under Article 46(2) CISG.<sup>119</sup> In practice, the buyer’s right to require substitute goods would be limited to those situations where repair is impossible because the buyer would be barred from requiring substitute performance whenever the seller offers a cure. Such a result was certainly not in the minds of the drafters as they had originally dedicated all of Article 46 CISG to the right to require substitute goods.<sup>120</sup>
3. A third significant view that has been advanced distinguishes between a breaching party’s qualified and unqualified right to cure. The unqualified right refers to a general right to cure, subject to a certain timeframe and other objective limitations

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<sup>117</sup> Enderlein and Maskow (n 9) 187; Andrew Babiak, ‘Defining “Fundamental Breach” Under the United Nations Convention on Contracts for the International Sale of Goods’ (1992) 6 *Temple International and Comparative Law Journal* 113, footnote 92; Graffi (n 1) 344.

<sup>118</sup> Jacob S Ziegel, ‘The Remedial Provisions in the Vienna Sales Convention: Some Common Law Perspectives’ in Galston and Smit (n 79) chapter 9, 9-1 to 9-43, 9-23.

<sup>119</sup> The buyer can request substitute delivery if the lack of conformity constitutes a fundamental breach.

<sup>120</sup> Ole Lando, ‘Obligations of the Seller’ in Bianca and Bonell (n 9) 245.

which the breaching party may exercise independent of any thing the aggrieved party may do in respect to that breach. A qualified right means that the breaching party's right to cure depends upon the aggrieved party's failure to use some power or exercise some right that renders cure unavailable. The seller's right to cure is an unqualified right for any non-fundamental breach while it is qualified under Article 49(1) CISG. The opening of Article 48(1) states that it is 'subject to Article 49' and this creates a hierarchy in the terms cure and avoidance. The buyer may avoid the contract where the seller's breach amounts to fundamental breach regardless of whether the seller offers to cure or not. This conclusion is supported by Article 48(2) which suspends the buyer's right to declare the contract avoided during any curative period requested by the seller. The buyer's refusal to accept cure, according to Article 48(2), has no legal effect other than to maintain his power to avoid the contract effective. Thus, the seller's right to cure is qualified upon the buyer's acceptance, whether by assenting or failing to refuse the seller's curative offer.<sup>121</sup>

Defining fundamental breach as incurable breach or one that the seller refuses to cure makes international sales unnecessarily uncertain. Buyers become uncertain whether they are entitled to avoid the contract with the breaching seller and so they pursue an alternative means of obtaining the goods they want. The sellers, on the other hand, must also be certain of their rights in contracts across national borders where their ability to dispose of the goods is more limited. The seller's rights can be protected effectively according to Article 48(2) and 48(3) CISG.<sup>122</sup> However, the uncertainty of whether the curable breach amounts to a

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<sup>121</sup> Yovel (n 109) 10.

<sup>122</sup> Eric C Schneider, 'The Seller's Right to Cure under the Uniform Commercial Code and the United Nations Convention of International Sale of Goods' (1989-1990) 7 *Arizona Journal of International and Comparative Law* 69.

fundamental breach would worsen the buyer's position because they would be uncertain whether the seller would cure or not, or know whether the cure would be successful.

### 7.7.3 CISG's case law

In case law, there are some reported cases where some courts have stated, mostly in the obiter dictum, that the buyer's right to avoid the contract is contingent upon giving the seller a proper opportunity to cure.<sup>123</sup> Such statements do not necessarily mean that curable breach is not fundamental. These statements may be a result of particular circumstances in these cases or they may refer to the seller's unqualified right to cure because the breach was not fundamental from the outset.<sup>124</sup> In addition, such statements could be interpreted to mean that if the seller refuses or fails to cure, the buyer may restore his right to avoid the contract if he had already lost it.<sup>125</sup>

A good example where the court held that there was no fundamental breach if there was a serious offer to cure the defect is the judgment of the Koblenz Court of Appeals on 31 January 1997.<sup>126</sup> The Court stated that in order to 'determine the occurrence of a fundamental breach regard is to be had not only to the gravity of the breach, but also to the willingness of the seller to cure the defect'. This must be read restrictively in the light of the post-breach negotiations between the parties in that specific case. In this case, a sale of acrylic blankets had gone wrong. The seller had broken an exclusive distribution agreement, the delivered

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<sup>123</sup> See, for instance, *Designer Clothes Case* Appellate Court Köln, Germany (14 October 2002); *Acrylic Blankets Case* (n 91); *Inflatable Triumphal Arch Case* Commercial Court of the Canton of Aargau, Switzerland (5 November 2002).

<sup>124</sup> The breach did not justify avoidance of the contract since the non-conformity did not deprive the buyer of what he was entitled to expect under the contract; *Marques Roque Joachim v Manin Rivière* Appellate Court Grenoble, France (26 April 1995); *Coke Case* Appellate Court München, Germany (2 March 1994); for the contrary view regarding these decisions see Koch (n 4) 255.

<sup>125</sup> The unsuccessful attempt to cure may amount to a fundamental breach that entitles the buyer to avoid the contract *Furniture Case* Appellate Court Oldenburg, Germany (1 February 1995); *Wall Tiles Case* District Court Baden-Baden, Germany (14 August 1991); see also Koch (n 4) 156.

<sup>126</sup> *Acrylic Blankets Case* (n 91); This case is recurrently cited as an example of precedence of the seller's right to cure over the buyer's right to avoid the contract. See Koch (n 4) 253; Mullis (n 29) 343; Graffi (n 1) 23.

goods were defective and five acrylic blanket rolls were missing. The buyer refused to pay the purchase price because of these allegations but he had never declared the contract avoided. Attempts to settle the dispute in the presence of the Spanish manufacturer of the goods, who had offered to make a substitute delivery against payment of the purchase price, were unsuccessful and were rejected by the buyer. The Koblenz Court of Appeals found that the buyer's notice of non-conformity was not specific enough. The buyer had communicated that five rolls of acrylic blankets were missing but did not specify how he wished the seller to cure this defect in the spirit of Article 39 CISG. Therefore, the buyer could not declare the contract avoided as per Article 51(1) CISG as he had lost the right to rely on a lack of conformity. In particular, a declaration of the buyer could not be interpreted as a declaration of avoidance as the subsequent conduct of the buyer was incompatible with such an interpretation according to Article 8(3) CISG. In the case at hand, the Court excluded the presence of a fundamental non-conformity, including lack of both quantity and quality,<sup>127</sup> because the buyer, who had lost his right to avoid the contract, had unjustifiably rejected the seller's offer to remedy the non-conformity by delivering substitute goods. This was not a result of applying Article 48(1) CISG since the Court expressly acknowledged the prevalence of the buyer's right to avoid the contract over the seller's right to cure. In the quoted statement above, there was no doubt that the Court referred to the revival of the buyer's right to avoid the contract upon a seller's failure to cure the defect.<sup>128</sup> Therefore, this decision cannot rightfully serve as an example of the reliance of the fundamentality of the breach upon the seller's intention to cure.

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<sup>127</sup> The buyer had failed to prove the conclusion of a distributorship agreement; therefore, the question whether breach of such agreement constituted a fundamental breach remained undecided. However, the court stated that the breach of a secondary obligation under the contract, like that deriving from an exclusive distributorship agreement, if proved, may amount to a fundamental breach giving a right to avoid the contract (Art 49(1)(a) CISG (n 12)).

<sup>128</sup> But see different analysis of this case by Koch (n 4) 253; Mullis (n 29) 343; Graffi (n 1) 345; Huber (n 1) 23.

In the case law, it is by no means certain that the courts give precedence to the buyer's right to avoid the contract over the seller's right to cure where the breach of the seller is fundamental. The buyer is entitled to avoid the contract for fundamental breach immediately, without being obliged to accept the seller's offer to cure.<sup>129</sup>

An understanding of the relationship between the occurrence of fundamental breach and the seller's right to cure is important in order to evaluate the buyer's right to avoid the contract according to Article 49 CISG. The definition of fundamental breach is independent of the seller's right to cure. Article 48(1) subjected the seller's right to cure to the buyer's right of avoidance; and Article 48(2) entitles the buyer to reject the seller's offer to cure. The buyer's right to avoidance precedes the seller's right to cure a fundamental breach in all cases when the projected time of performance has passed. The curability of fundamental breach would not preclude the buyer's right to avoid the contract. Articles 48(2) and 49 CISG give priority to the buyer's right to avoidance rather than the seller's attempt to cure.

It seems evident that fundamental breach of non-conformity must only be decided on a case by case basis. Most of the decisions that have ruled a seller's breach to be fundamental came to this conclusion through considerable and careful assessment of the relationship between detriment as defined in the loss of contractual expectations and foreseeability. Foreseeability is an element that can be used to interpret the contract or the reasonable range of strict compliance that the aggrieved party is entitled to under the contract. The aggrieved party is not entitled to avoid the contract if it was unreasonable for the innocent party to rely on the seller's skills and judgment to meet his expectations related to the breached obligation. The need for certainty with respect to the avoidance remedy by the buyer under the CISG invites

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<sup>129</sup> *Foliopack v Daniplast* Court of First Instance Parma, Italy (24 November 1989); *Shoes Case* Appellate Court Frankfurt, Germany (17 September 1991); *Furniture case* (n 125); *Stainless Steel Wire Case* Supreme Court Germany (25 June 1997); *Scaffold Fittings Case* ICC Arb Case No 7531 (1994); Yovel (n 109) 10-11; Graffi (n 1) 345.

the courts to define the parties' contractual expectations before assessing the fundamentality of the breach.

## **7.8 Conclusion**

Upon breach of an international sales contract, there is a need for predictable rights to the remedies available more than a need to subject these contracts to uncertain uniform international law. This is because if the breach was not fundamental, the avoiding party will be in breach and will have to pay damages for wrongful avoidance. The definition of fundamental breach in Article 25 CISG is not clear enough to ensure the consistency and predictability of the innocent party's right to avoid the contract. Different scholarly interpretations have created different tests of fundamental breach. The elements of fundamental breach that are found in most scholarly writing, such as economic loss, curability of the defect, and the remedy-oriented approach lack a legislative foundation. Further, they do not explain why these approaches have not been followed by the courts consistently. Some court decisions have ruled in favour of a contract despite the availability of such elements in most of the court decisions on non-avoidance. The exact inter-relationship between these factors and the definition of fundamental breach remains a question of some difficulty and is one that may not be particularly productive of certainty. In addition, following such approaches that ignore contractual expectations and foreseeability may lead to contradictory results.

This study attempts to define the relationship between essential detriment and foreseeability as stated in Article 25 CISG and commonly understood in legal literature and court decisions. The study shows that the foreseeability test was either ignored or misunderstood in terms of its central role in the formation of fundamental breach. Foreseeability is not a defence for the breaching party to invoke where the other party has been deprived of what it was entitled to

expect under the contract. It seems that foreseeability is an element to interpret the will of the parties which the court may examine by itself without being invoked by the breaching party.

In practice, national courts and tribunals of different contracting states will inevitably be affected by varying interpretations of fundamental breach. There is neither a higher court to ensure uniformity of CISG application nor an official interpretation to clarify these unresolved issues. The consistent and uniform application of Article 25 CISG seems an unrealistic hope in the absence of any official attempt to promote the uniform understanding and application of fundamental breach. National courts and tribunals continue to have the individual discretion to decide whether a contract has been rightfully avoided.

## Chapter 8: The consequences of avoidance

Section V of the Convention lays down the framework to deal with the effects of avoidance between the parties. The Convention does not deal with the effect of avoidance on third parties, those whose interests could be affected by avoidance such as the common and private successors of the buyer and the debtors of both parties. Such effects are governed by the applicable law according to the rules of private international law; the Convention deals only with the rights and obligations of the parties to a sale contract.<sup>1</sup>

Upon avoidance of the sale contract under the CISG, both parties are released from their obligations for the future, subject to any damages that may be due, any provisions of the contract for the settlement of disputes or any other provision of the contract governing the rights and obligations of the parties' consequent to the avoidance of the contract.<sup>2</sup> Each party of the avoided contract has the right to recover his own performance. If the seller has declared avoidance of the contract because of the buyer's failure to pay for the delivered goods, the seller will have the right to recover the goods delivered and the buyer, if he paid his part of the price, will have the right to recover what he paid.

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<sup>1</sup> Denis Tallon, 'Article 81' in CM Bianca and MJ Bonell (eds), *Commentary on the International Sales Law: The 1980 Vienna Sales Convention* (Giuffrè 1987) 601, 602ff; Chengwei Liu, 'Effects of Avoidance: Perspectives from the CISG, UNIDROIT Principles and PECL and case law' (June 2005) para 1.

<sup>2</sup> Article 82(1) United Nations Convention on Contracts for International Sale of Goods (11 April 1980, entered into force 1 January 1988) 1489 UNTS 3 (CISG) provides that: 'Avoidance of the contract releases both parties from their obligations under it, subject to any damages which may be due. Avoidance does not affect any provision of the contract for the settlement of disputes or any other provision of the contract governing the rights and obligations of the parties consequent upon the avoidance of the contract.'; Article 7.3.5(1) UNIDROIT, *Principles of International Commercial Contracts* (3<sup>rd</sup> edn, 2010) (PICC) provides: 'Termination of the contract releases both parties from their obligation to effect and to receive future performance.'; Article 9:305(1) Commission on European Contract Law, *Principles of European Contract Law* (Parts I and II revised 1998, Part III 2002) (PECL) '(1) Termination of the contract releases both parties from their obligation to effect and to receive future performance, but, subject to Articles 9:306 to 9:308, does not affect the rights and liabilities that have accrued up to the time of termination.'



The parties may, by mutual consent, agree to cancel the contract and to release each other from contractual obligations. In such cases of ‘consensual avoidance’ the rights and obligations of the parties are governed by the parties’ termination agreement.<sup>3</sup>

The effect of avoidance will be studied under three main headings: parties’ release from their obligations for the future; preservation of the right to due damages; preservation of post-avoidance contractual provisions.

## **8.1 The effects of avoidance on the contractual terms and obligations**

### **8.1.1 Parties’ release from their obligations for the future**

Declaration of avoidance makes it clear to the breaching party that the contract will not be performed and both parties are released from their obligations under it for the future. Any unperformed contractual obligation, or duties concerned thereto, is cancelled and the parties regain their freedom of disposition.<sup>4</sup> The seller need not deliver the goods and the buyer need not take delivery and pay for them. The seller is not allowed to claim the price and the buyer cannot claim the delivery of the goods.<sup>5</sup> If the contract is partially avoided, the parties are released from their obligations only on the part of the contract that has been avoided.<sup>6</sup>

### **8.1.2 Preservation of the right to due damages**

Avoidance of the contract does not prevent the injured party from claiming damages nor does it nullify clauses agreed to in the contract on the settlement of disputes and the consequences

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<sup>3</sup> *Rolls Of Chips Packing For Food Mixtures And Spices For Production Of Chips Case* Tribunal of International Commercial Arbitration at the Russian Federation Chamber of Commerce and Industry, Russia 82/1996 (3 March 1997); *Dividing Wall Panels Case* Supreme Court Austria (29 June 1999).

<sup>4</sup> Tallon (n 1) note 2.2, 602; John Honnold, *Uniform Law for International Sales under the 1980 United Nations Convention* (3rd edn, Kluwer Law International 1999) 502, para 440.1, 502; Christiana Fountoulakis, ‘Article 81’ in *Schlechtriem and Schwenger* (n 1) para 5, 1101.

<sup>5</sup> UNCITRAL, ‘Commentary to the Draft Convention’ UN Doc (A)CONF.97(5) 175; see also Jelena Vilus, ‘Provisions Common to the Obligations of the Seller and the Buyer’ in Petar Sarcevic and Paul Volken (eds), *International Sale of Goods: Dubrovnik Lectures* (Oceana 1986) chapter 7, 239, 257.

<sup>6</sup> Tallon (n 1) 602; Liu (n 1) para 2.

of avoidance.<sup>7</sup> Avoidance, as opposed to the situation in which a contract is terminated because it has become impossible to perform,<sup>8</sup> does not release parties from their obligations to pay damages.<sup>9</sup> The Convention permits the aggrieved party to claim damages in addition to avoidance and restitution. This rule is in harmony with the various projects on international sales laws. Under the ULIS,<sup>10</sup> UNIDROIT<sup>11</sup> and PECL,<sup>12</sup> the avoidance of the contract does not affect the right of the avoiding party to claim damages. In order to retain the right to damages after avoidance of the contract, the non-performance has to be due to the other party's unexcused failure to perform. If the failure to perform was a result of an impediment that prevented the debtor from implementing his obligations, this impediment would lead to exemption from performance and the aggrieved party would be entitled to avoid the contract and recover what has already been performed without having the right to damages.<sup>13</sup>

Once again, this rule of plurality of remedies prevails in many domestic laws and it permits the aggrieved party to claim damages in addition to avoidance. It is basic law that the

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<sup>7</sup> Article 82(1) CISG (n 2).

<sup>8</sup> Article 79(1) CISG (n 2) provides that: 'A party is not liable for a failure to perform any of his obligations if he proves that the failure was due to an impediment beyond his control and that he could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences.'

<sup>9</sup> Article 81(1) CISG (n 2); see also *Case Resolution No 7-P* Constitutional Court of the Russian Federation (27 April 2001).

<sup>10</sup> Articles 78(1) Convention Relating to a Uniform Law for the International Sale of Goods (1 July 1964) 834 UNTS 169 (ULIS) provides that: 'Avoidance of the contract releases both parties from their obligations thereunder, subject to any damages which may be due.'

<sup>11</sup> Article 7.3.5(2) UNIDROIT (n 2) provides that 'Termination does not preclude a claim for damages for non-performance.'

<sup>12</sup> Article 8:102: PECL (n 2) 'Remedies which are not incompatible may be cumulated. In particular, a party is not deprived of its right to damages by exercising its right to any other remedy.'; Article 9:305 (1) 'Termination of the contract releases both parties from their obligation to effect and to receive future performance, but, subject to Articles 9:306 to 9:308, does not affect the rights and liabilities that have accrued up to the time of termination.'

<sup>13</sup> Article 79 CISG (n 2); Article 7.4.1 UNIDROIT (n 2) provides that 'Any non-performance gives the aggrieved party a right to damages either exclusively or in conjunction with any other remedies except where the non-performance is excused under these Principles.'; Article 8:101 (2) PECL (n 2) 'Where a party's non-performance is excused under Article 8:108, the aggrieved party may resort to any of the remedies set out in Chapter 9 except claiming performance and damages.'; see also Khaled Abd El Hamid, 'The Avoidance of the Contract for International Sale of Goods according to the Vienna Convention 1980' (PhD Thesis, Cairo University, 2001) para 393.

aggrieved party when confronted with a material breach of contract is entitled to damages whether he has chosen either to avoid the contract or to require specific performance.<sup>14</sup> However, some legal systems do not permit a plurality of remedies.<sup>15</sup> Early on in the development of common law, case law and statutory rules denied the buyer compensation for damages if he terminated the contract by requiring the seller to take back defective goods. When the seller breached one of his obligations, the buyer had to either forfeit his right to damages or bear the burden of disposing of the defective goods. This early rule may have been useful to defeat termination (or rejection) based on trivial grounds. However, this approach has been eroded or abandoned;<sup>16</sup> a buyer who rejects non-conforming goods or cancels the contract on some other ground is not thereby deprived of his entitlement to damages.<sup>17</sup> A similar approach has been taken under the UCC. The expressions ‘cancellation’ or ‘rescission’ of the contract, unless an intention to the contrary clearly appears, should not be construed as a renunciation or discharge of any claim in damages for an antecedent breach.<sup>18</sup>

Thus, the claim for damages under the Convention serves to complete the system of remedies by providing compensation in cases where other remedies do not lead to adequate

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<sup>14</sup> Abd El Hamid K, ‘The Avoidance of the Contract for International Sale of Goods according to the Vienna Convention 1980’ (PhD Thesis, Cairo University, 2001) para 392.

<sup>15</sup> Some national laws, such as English, German and Hungarian ones, do not allow combining the remedy of avoidance of a contract with an action for damages; Michael Will, ‘Article 45’ in Bianca and Bonell (n 1) 331.

<sup>16</sup> Honnold (n 4) 302.

<sup>17</sup> Jacob S Ziegel and Claude Samson, ‘Report to the Uniform Law Conference of Canada on Convention on Contracts for the International Sale of Goods’ (July 1981) comment on article 45.

<sup>18</sup> Section 2-720 of the Uniform Commercial Code (UCC) regulating the effect of ‘cancellation’ or ‘rescission’ on claims for antecedent breach provides that: ‘Unless the contrary intention clearly appears, expressions of ‘cancellation’ or ‘rescission’ of the contract or the like shall not be construed as a renunciation or discharge of any claim in damages for an antecedent breach.’ The American Law Institute and the National Conference of Commissioners on Uniform State Laws, *Uniform Commercial Code* (2012).

compensation.<sup>19</sup> The aggrieved party may claim damages under the rules of the Convention or according to any clauses relating to the arrangements that have been agreed.<sup>20</sup>

### **8.1.3 Preservation of post-avoidance contractual provisions**

Under CISG avoidance there is no room for the argument that when a contract is avoided those contractual terms that are meant to remain viable even after avoidance become void as a consequence of avoidance. Article 81(1) CISG expressly states that:

Avoidance does not affect any provision of the contract for the settlement of disputes or any other provisions of the contract governing the rights and obligations of parties consequent upon the avoidance of the contract.<sup>21</sup>

Under the ULIS, this same rule was less detailed and comprehensive. Such a solution was not expressly approved by the ULIS and neither did it address the issue of preservation of those clauses agreed to in the contract on the settlement of disputes or clauses of avoidance. The other international instruments for sales contracts have followed the same approach as the CISG and have expressly granted the validity of such clauses.<sup>22</sup> There are two categories that may include post-avoidance rights and obligations clauses: settlement of dispute provisions and preservation of provisions agreed to in the contract on the consequences of avoidance.

#### **8.1.3.1 Settlement of dispute provisions**

The CISG recognizes the validity of settlement of dispute clauses despite the avoidance of the contract. These clauses mainly include forum selection clauses, arbitration clauses and

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<sup>19</sup> Will (n 15) 332.

<sup>20</sup> Tallon (n 1) note 2.2, 603.

<sup>21</sup> See also UNCITRAL, *Digest of Case Law on the United Nations Convention on the International Sale of Goods* (United Nations 2008) article 81.

<sup>22</sup> Article 7.3.5(3) provides that 'Termination does not affect any provision in the contract for the settlement of disputes or any other term of the contract which is to operate even after termination'; PECL Article 9:305 (n 2) 'Termination does not affect any provision of the contract for the settlement of disputes or any other provision which is to operate even after termination.'

renegotiation clauses that were designed to resolve conflicts resulting from unforeseeable changes in circumstances.<sup>23</sup> Preservation of such clauses is justified because these clauses are separated from the essence or core obligations arising out of the contract so that they are distinguished from the mutual, legal and economic performances under the contract. The intention of the parties in their agreement to these terms and in including them in the contract is to resolve disputes that may arise between them in the future. Their intention is to apply these terms only after such disputes have arisen between them. If the arbitration clause was agreed in the contract and one of the parties declared avoidance, any dispute that arose between the parties regarding the justification of avoidance or the amount of due damages that occurred should realize this condition and solve the dispute in accordance with it. It would not be practical to ignore this condition since it was only agreed for this purpose.<sup>24</sup>

Domestic laws generally accept this rule of retention of the terms of the dispute settlement and apply it despite avoidance of the contract. This rule was settled under the arbitration clause, whether it was contained in the same contract or in a separate agreement. The retention of the arbitration clause is independent from the destiny of the contract of sale and it should not be affected by the invalidity of the contract or its dissolution.<sup>25</sup> However, the terms of the dispute settlement do not apply if they were void. The terms of the dispute settlement must be valid in themselves in order to be preserved after the avoidance of the contract. The Convention does not regulate the validity of the contract or its terms but the related validity must be judged in accordance with the applicable law.<sup>26</sup>

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<sup>23</sup> Tallon (n 1) 603.

<sup>24</sup> Abd El Hamid (n 13) para 394; Honnold (n 4) no 442, 506; Ulrich Magnus, 'The Remedy of Avoidance of Contract Under CISG: General Remarks and Special Cases' (2005-06) 25 *Journal of Law and Commerce* 423, 431.

<sup>25</sup> Tallon (n 1) 603; Abd El Hamid (n 13) para 394.

<sup>26</sup> Article 4 CISG (n 2)

### **8.1.3.2 Preservation of provisions agreed to in the contract on the consequences of avoidance**

Provisions that are meant to regulate the rights and obligations of the parties in relation to avoidance remain effective despite avoidance and do not cease to exist until they are implemented or cancelled by agreement of the parties.<sup>27</sup> Clauses which spell out the consequences of the non-performance of the contract: penalties, liquidated damages and clauses restricting or excluding liability are deemed effective notwithstanding the avoidance of the contract, provided that these clauses are valid according to the applicable law which may not always be the case, namely, concerning penalties.<sup>28</sup>

The Convention usage of general expressions and examples for what can be kept after avoidance allows for the inclusion of any rights and obligations that would be inherently viable after avoidance of the contract. Examples of such rights and obligations are the obligation of the buyer to take reasonable measures appropriate to the circumstances to ensure the preservation of the goods until they are delivered to the seller, the buyer's right to recover expenses incurred to reserve the goods,<sup>29</sup> as well as the buyer's right to recover the price that has already been paid with interest that has been agreed on the price, calculated from the day of due payment.<sup>30</sup>

These obligations may also include the obligation to maintain confidentiality. If the seller disclosed confidential information to the buyer that was necessary for the production of related goods that had not yet become common knowledge, the buyer will remain, even after avoidance, obliged not to disclose such confidential information. Indeed, the obligation to

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<sup>27</sup> Jianming Shen, 'Declaring the Contract Avoided: The UN Sales Convention in the Chinese Context' (Winter 1997) 10(1) *New York International Law Review* 7, 35.

<sup>28</sup> Tallon (n 1) 603.

<sup>29</sup> Article 86 (1) CISG (n 2).

<sup>30</sup> Article 84 (1) CISG (n 2)

ensure confidentiality after avoidance is one of the most important obligations arising from the negotiation stage prior to the conclusion of the contract if it is not concluded. This is because each party is committed not to take advantage of what he could learn from information in the negotiation phase in case of failure of the negotiations. The parties to a contract may negotiate separate agreements to regulate their relationships and responsibilities that result from the negotiation stage before the conclusion of the contract. Agreement to abide by confidentiality at the stage of the negotiations aims to prevent any of the negotiating parties from disclosing what was exchanged through negotiation to others, or the use of such data or information by any of the parties without prior authorization of the owner of this information.<sup>31</sup>

A more liberal interpretation claimed the application of such clauses, which were agreed to in the contract on the consequences of avoidance, to the situations that may have not been expressly agreed between the parties. If, for example, a penalty is stipulated in case of delay in the delivery and the contract is finally avoided on the ground of lack of conformity, the payment of the said penalty is an obligation 'consequent upon the avoidance of the contract' even though the avoidance is not declared as a result of the delay. Such an interpretation relies on two points: the first is the spirit of Article 81 CISG which aims to prevent the invalidation of clauses which may prove useful in resolving a conflict between the parties; the second is that a penalty, being a substitute for damages, should survive notwithstanding avoidance according to Article 81(1), first sentence.<sup>32</sup> However, this liberal interpretation seems to mix up the contractual interests of the parties and to forfeit the parties' intention of a particular penalty clause. When a contract stipulates a penalty in a specific case of breach, a delay in delivery for instance, this implicitly means such a penalty clause may not be

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<sup>31</sup> Abd El Hamid (n 13) para 396.

<sup>32</sup> Tallon (n 1) 603.

applicable if the contract were avoided because of some other type of fundamental breach. Application of such a penalty clause would be against the parties' intention. Therefore, a court may not resort to such liberal interpretation unless an agreement to that effect can be inferred from the rest of the contractual provisions.

## **8.2 Damages**

### **8.2.1 The remedy of damages under the CISG**

Articles 45 and 61 CISG provide the basis of the respective rights of the buyer and seller to claim damages for breach. These rules make it clear that claims for damages can be asserted in addition to other legal consequences of breach of contract. However, a claim for damages under the CISG is intricately interwoven with the remedy of avoidance of contract because, upon avoidance, each party is obliged to make restitution of whatever it has received, and such restitution would generally involve an aspect of compensation which may affect the calculation of damages.

In Section II of Chapter V of the Convention, Articles 74 to 79 include provisions available to either party to the contract, seller or buyer, to claim damages for breach of the contract.<sup>33</sup> Another provision that is relevant is found in Article 84 CISG which imposes on parties to a validly avoided contract obligations to account for the benefits obtained by the performance of the other party. The Convention determines a general rule for the calculation of damages in Articles 74 and 77. According to this rule, the extent or the measurement of damages operates on the general principle of full compensation. This principle can be broken down into three specific factors: (1) the injured party should receive monetary compensation equal to the loss, including loss of profit, in order to place him as near as possible to the economic position he

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<sup>33</sup> A third person who suffered a loss as a consequence of the breach of contract may claim damages only under the applicable domestic law; see Victor Knapp, 'Article 74' in Bianca and Bonell (n 1) 538, 539.



would have found himself in had the contract been duly performed<sup>34</sup> provided that; (2) such damages do not exceed the loss which were, or ought to have been, foreseeable to the party in breach at the time of contract conclusion, as a possible consequence of the breach; and (3) the injured party had taken such reasonable measures to mitigate the loss resulting from the breach.

### **8.2.2 Damages in case of avoidance**

Whereas Articles 74,<sup>35</sup> 77,<sup>36</sup> 78,<sup>37</sup> and 79<sup>38</sup> provide for the general rules that apply whether or not the contract has been avoided, Articles 75<sup>39</sup> and 76<sup>40</sup> provide for special customization of the general rules that apply only when the contract has been avoided. There are two alternative damages formulas applicable if the contract is avoided. Article 75 measures damages on a repurchase price by the buyer or a resale by the seller when the aggrieved party enters into a substitute transaction. Article 76 measures damages on the current price when the aggrieved party does not enter into a substitute transaction. Under both formulas, the general rules of Article 74 would also apply as a subsidiary rule to calculate damages which cannot be covered under Articles 75 or 76.<sup>41</sup> This damages amount may be adjusted by adding further damages recoverable under Article 74 or by deducting the loss that could have been avoided if the aggrieved party had mitigated its damages in accordance with Article 77. The recovery of damages under Articles 75 or 76 is only available when the contract has been

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<sup>34</sup> Knapp (n 33) 539.

<sup>35</sup> Article 74 sets out the Conventions general formula for the calculation of damages.

<sup>36</sup> Article 77 deals with the duty of the aggrieved party to take reasonable steps to mitigate losses.

<sup>37</sup> Article 78 entitles a party to interest on late payment of the price or any sum in arrears.

<sup>38</sup> Article 79 specifies the circumstances in which a party 'is not liable' for failing to perform its obligations.

<sup>39</sup> Article 75 deals with calculation of damages in case the buyer has bought goods in replacement or the seller has resold the goods.

<sup>40</sup> Article 76 deals with calculation of damages in case there is a current price for the goods and the party claiming damages has not made a purchase or resale under article 75.

<sup>41</sup> Knapp (n 33) 539.

effectively avoided by the aggrieved party or when the declaration of avoidance is not needed because the seller had made it clear that he would not perform.<sup>42</sup>

### **8.2.2.1 Substitute transaction**

Article 75 measures damages as the difference between the contract price and the price in a substitute transaction closed by the aggrieved party. Assuming the second transaction is a substitute for the first, there would be little or no loss if the cover price obtained in the second transaction equalled or exceeded the price of the breached contract.<sup>43</sup> Thus, the buyer can get the difference between the original contract price and the price paid for the goods in replacement of those promised in the avoided contract on the assumption that the latter price was higher than the price of the original contract;<sup>44</sup> and the seller can get the difference between the original contract price and the price that it received from the sale to some other buyer of the goods identified in the avoided contract on the assumption that the latter price would be less than the price of the original contract. The reasoning behind the substitute transactions rule is that, since avoidance of the contract releases both parties from their obligations, the injured party who has declared the contract avoided will normally seek out a substitute transaction. The buyer would normally be expected to purchase substitute goods or the seller to resell the goods to a different buyer.<sup>45</sup> Furthermore, encouraging the aggrieved party to achieve the intended purpose of the contract in substitute performance is likely to minimize the losses consequent to the breach.<sup>46</sup>

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<sup>42</sup> *Iron Molybdenum Case* Appellate Court Hamburg, Germany (28 February 1997); see also UNCITRAL (n 21).

<sup>43</sup> Joseph Lookofsky, 'The 1980 United Nations Convention on Contracts for the International Sale of Goods' in J Herbots and R Blanpain (eds), *International Encyclopaedia of Laws – Contracts*, Suppl 29 (Kluwer Law International December 2000) 1, 155ff.

<sup>44</sup> Knapp, 'Article 75' in Bianca and Bonell (n 1) 549, 550.

<sup>45</sup> Knapp, 'Article 76' in Bianca and Bonell (n 1) 552, 553.

<sup>46</sup> Knapp (n 44) 550.

There are two conditions that must be satisfied for applying the damages formula set out in Article 75.<sup>47</sup> The substitute transaction must be undertaken in a ‘reasonable manner’ and it must be concluded ‘within a reasonable time after avoidance’. An aggrieved buyer may not simply cover the transaction at any price or at any time, and a seller who is aggrieved by a buyer’s breach may not resell at any price or at any time. Both of these restrictions are based on the loss mitigation principle set out more generally in Article 77 CISG.<sup>48</sup> If these conditions are not satisfied, the aggrieved party may recover damages as if the substitute transaction was never concluded.

#### **8.2.2.1.1 Reasonable manner**

An aggrieved party must conclude the substitute transaction in a reasonable manner. There is no express definition for reasonableness in the Convention. Article 75 CISG requires that the substitute transaction must be connected to the sales contract, ie it must be suitable and intended to satisfy the promisee’s expectation interest.<sup>49</sup> This means, for example, that the substitute transaction must be entered into to satisfy the expectation interest of the aggrieved party, not to cause detriment to the party in breach. In order to enter into a reasonable substitute transaction, a seller must aim for the highest achievable price and a buyer for the lowest requested price; these do not necessarily have to exactly coincide with the average market price.<sup>50</sup> An arbitral tribunal held that a deal was not a reasonable alternative to the loss suffered by the injured party where an aggrieved seller resold the goods for approximately a quarter of the contract price.<sup>51</sup> A sale at market value at approximately the same freight terms

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<sup>47</sup> Honnold (n 4) 453.

<sup>48</sup> Peter Schlechtriem, ‘Calculation of damages in the event of anticipatory breach under the CISG, Freiburg, Germany’ para II <<http://www.cisg.law.pace.edu/cisg/biblio/slechtriem20.html>> accessed 22 June 2015.

<sup>49</sup> Ingeborg Schwenzer, ‘Article 75’ in *Slechtriem and Schwenzer* (n 1) 1027.

<sup>50</sup> *ibid* para 6, 1030.

<sup>51</sup> The court calculated damages under Article 76 rather than Article 75; *Frozen Bacon Case* Appellate Court Hamm, Germany (22 September 1992).

was found to be a reasonable substitute sale.<sup>52</sup> Another decision concluded that an aggrieved buyer must act as a prudent and careful businessperson who buys goods of the same kind and quality, ignoring unimportant, small differences in quality.<sup>53</sup> In short, what is a reasonable manner depends on the circumstances of the case, bearing in mind that the promisee should not violate his duty to mitigate the loss.

#### **8.2.2.1.2 Reasonable time**

An aggrieved party must conclude the substitute transaction within a reasonable time after avoidance of the breached contract.<sup>54</sup> This is due to the fact that the delay in conducting the substitute transaction may lead to an increase in the losses suffered by the injured party due to a price change. Noting that a reasonable time begins to run only when the contract is avoided, a court found that the aggrieved seller acted within a reasonable time by reselling shoes made for the winter season within two months when it was established that most potential buyers had already bought winter shoes by the time the contract was avoided.<sup>55</sup> Resale of scrap steel within two months of the time the seller avoided the contract has also been found to be reasonable.<sup>56</sup> Another court found that an aggrieved seller who resold a printing press within six months after expiration of an additional period given to the buyer to perform under Article 63 had acted within a reasonable time.<sup>57</sup> These decisions show that what is a reasonable time will depend on the nature of the goods and the circumstances.

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<sup>52</sup> *Downs Investments v Parana Steel* Supreme Court of Queensland, Australia (17 November 2000).

<sup>53</sup> *Chemical Fertilizer Case* ICC Arb Case No 8128 (1995).

<sup>54</sup> But one decision appears to construe the reasonable time requirement to mean that an aggrieved party is obliged to wait a reasonable period of time under Article 75 in order to claim damages, see *Metal Concentrate Case* ICC Arb Case No 8574 (September 1996); see also UNCITRAL (n 21).

<sup>55</sup> *Shoes Case* Appellate Court Düsseldorf, Germany (14 January 1994); see also UNCITRAL (n 21).

<sup>56</sup> *Downs Investments v Parana Steel* (n 52); see also UNCITRAL (n 21).

<sup>57</sup> *Bielloni Castello v EGO (Printer Device Case)* Appellate Court Milan, Italy (11 December 1998); see also UNCITRAL (n 21).

If the deal is not a reasonable alternative to the loss suffered by the injured party, it is considered that it violates the conditions required by Article 75. If there is a significant difference between the contract price and the price in the substitute transaction, the damages recoverable under Article 75 may be reduced pursuant to Article 77 because of the aggrieved party's failure to mitigate damages.<sup>58</sup> Alternatively, the injured party must resort to Article 76 and measure the damages against the current market price as if the substitute transaction was never concluded.<sup>59</sup>

If the avoiding seller makes a substitute transaction, it will be especially important when the goods have been specially manufactured or if for some other reason they are so unique that it would be difficult to establish a current price under Article 76.<sup>60</sup> However, in a situation where a seller's own supply exceeds his own demand, there would be no causal relationship between a buyer's breach and a seller's subsequent sale.<sup>61</sup> It may be difficult or impossible to determine which of many contracts of purchase or sale replaced the one breached. In such a situation, Article 75 is inadequate to fully compensate the seller. The loss suffered by reason of a buyer's breach, in this instance, can only be recovered by damages under Article 74 in order to protect the seller's justifiable loss of potential profit.<sup>62</sup> If the goods have a market price, this will generally have to be viewed as the reasonable price in the light of the duty to mitigate loss in Article 77.<sup>63</sup>

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<sup>58</sup> *Chemical Fertilizer Case* (n 53); *Internationale Jute Mattschappij v Marín Palomares* Supreme Court Spain (28 January 2000); *Jewelry Case* Supreme Court Austria (28 April 2000); *Printer Device Case* (n 58).

<sup>59</sup> UNCITRAL (n 5) 'Article 71'; Jeffrey S Sutton, 'Measuring Damages Under the United Nations Convention on the International Sale of Goods' (1989) 50 *Ohio State Law Journal* 737, para III B.

<sup>60</sup> Honnold (n 4) 450.

<sup>61</sup> Knapp (n 45) 554.

<sup>62</sup> Lookofsky (n 43) 153.

<sup>63</sup> Schwenger (n 49) para 11, 1032; Knapp (n 45) 557; but see Honnold (n 4) 453, the 'current' price formula of Article 76 is applicable only if the aggrieved party 'has not made a purchase or resale under Article 75'.

### 8.2.3 The market-price rule

Article 76 measures damages as the difference between the contract price and a current (market) price at the time of avoidance. The market-price rule presupposes that the goods have not been undertaken with regard to the contract breached. If, however, the party claiming damages has taken over the goods before avoidance, the current price at the time of such taking over should be applied instead of the current price at the time of avoidance.<sup>64</sup>

Article 76 applies in cases where the contract is avoided and the aggrieved party does not enter into a substitute transaction. The current price rule does not presuppose official or unofficial market quotations as is required in stock exchange goods.<sup>65</sup> The question of whether there is a 'current price' for the goods must be examined in each case as a question of fact in the light of all the circumstances of the particular case.<sup>66</sup> The market price is the price generally charged in the market for goods of the same kind at the place where delivery of the goods should have been made. This invokes the rules on delivery in Article 31. In the most common international sales, this is the place for handing the goods over to the first carrier for transmission to the buyer; this is a convenient place for a seller to measure market price when the buyer's repudiation or breach prevents shipment.<sup>67</sup> If there is no current price at the place where the delivery of the goods should have been made, the injured party may refer to the current price of comparable goods at another place which serves as a reasonable substitute. It follows that a current price at a place different from the place where the goods should have been delivered may be used in calculating the damages as long as this current price can serve as a reasonable substitute to the non-existent current price at the place of

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<sup>64</sup> UNCITRAL (n 21).

<sup>65</sup> Chengwei Liu, 'Remedies for Non-performance: Perspectives from CISG, UNIDROIT Principles and PECL' (September 2003) para 15.3.3.1 <<http://www.cisg.law.pace.edu/cisg/biblio/chengwei.html>> accessed 23 June 2015.

<sup>66</sup> Knapp (n 45) 557.

<sup>67</sup> Honnold (n 4) 453.

delivery. Therefore, if there was a current price at the place of delivery, the injured party is not allowed to refer to the current price at a place different from the place of delivery even if such a current price would be more advantageous to him; nor can the party in breach object that some other price would be more advantageous to him.<sup>68</sup>

The reasonableness of such a substitution cannot be generally defined; it must be examined in each case from the point of view of an average merchant in the light of the justifiable interests of both parties.<sup>69</sup> One tribunal declined to use published quotations in a trade magazine because the reported quotations were for a different market from where the goods were to be delivered under the contract and adjustment of that price was not possible. Therefore, as a current price, the tribunal accepted a price negotiated by the aggrieved seller in a substitute contract which was not ultimately concluded.<sup>70</sup> Another tribunal found that the aggrieved party was unable to establish the current price for coal generally or for coal of a particular quality because the requirements of buyers varied and there was no commodity exchange.<sup>71</sup> Another court suggested that the auction realization value of goods held by an insolvent buyer might be relevant if the aggrieved seller were to seek to recover under Article 76.<sup>72</sup> Stating that the seller's lost profit was to be established under Article 76, a court affirmed an award of damages to an aggrieved seller in the amount of 10 per cent of the contract price because the market for the goods (frozen venison) was declining and the seller set its profit margin at 10 per cent, which was the lowest possible rate.<sup>73</sup> It has also been held that a current price for the purposes of Article 76 can be established using the methodology in

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<sup>68</sup> Knapp (n 45) 558; Bruno Zeller, 'Remarks on the manner in which the UNIDROIT Principles may be used to interpret or supplement Article 76 of the CISG' (October 2003)  
<<http://www.cisg.law.pace.edu/cisg/principles/uni76.html>> accessed 25 April 2015.

<sup>69</sup> Knapp (n 45) 557.

<sup>70</sup> *Silicate-Iron Case* CIETAC-Shenzhen Arbitration, China (18 April 1991).

<sup>71</sup> *Russian Coal Case* ICC Arb Case No 8740 (October 1996).

<sup>72</sup> *Roder v Rosedown* Federal District Court Adelaide, Australia (28 April 1995).

<sup>73</sup> *Frozen Meat Case* Appellate Court Braunschweig, Germany (28 October 1999).

Article 55 for determining the price under a contract that does not make provision for determining the price.<sup>74</sup>

### **8.3 Restitution**

Where performance has been exchanged under the contract, a party who has performed the contract either wholly or in part may, upon avoidance, claim restitution from the other party of whatever he (the first party) had supplied or paid.<sup>75</sup> The Convention allows a restitution claim for each of the parties of the avoided contract without distinction, whether the claim was from the breaching party or the aggrieved party. If making restitution is impossible because of the deterioration of the goods, the buyer may be deemed to have lost his right of avoidance unless he meets certain exceptions that are provided in Article 82 CISG, thus reallocating the risks of deterioration to the seller.

#### **8.3.1 Prospective or retrospective effects of avoidance**

The core effect of avoidance, whether retrospective or prospective, is disputed in comparative legal systems. The most obvious difference can be seen in systems such as French law which treat *résolution* as essentially retrospective and those using common law which sees termination as essentially prospective. According to the retrospective view, the avoided contract is treated by law as if it is void from the outset. This means that the parties are placed in the situation they would be in had the contract never been concluded at all.<sup>76</sup> On the other hand, common law legal systems do not carry the concept of avoidance or rescission this far. Under the prospective approach, the contract remains in existence with the restitutionary obligations being the reverse of the original obligations of performance. In common law and in the American Uniform Commercial Code, restitution as a remedy typically takes the form

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<sup>74</sup> *Furniture Leather Case* Appellate Court München, Germany (15 September 2004).

<sup>75</sup> Article 81(2) CISG (n 2).

<sup>76</sup> Tallon (n 1) para 2.5, 604.



of compensation in money measured by a benefit conferred. This is commonly justified by the need to prevent the unjust enrichment of the breaching party.<sup>77</sup> When goods have been delivered on credit, the unpaid seller only has the general claim of a creditor. In general, the goods do not have to be physically returned. Recovery of the goods must be based on wrongful (or fraudulent) conduct of the buyer in obtaining the goods or on his signed agreement that the seller retains a property (or security) interest in the goods.<sup>78</sup>

The difference in approach can be seen in relation to the property in the goods upon avoidance. According to the retrospective view, while the buyer's right to claim his money back is based on personal right actions (in personam remedies), the seller's right to claim the goods back is based on real right actions (in rem remedies) because the property in the goods reverts back to the seller (original owner). These actions in rem are regularly stronger remedies than in personam remedies and can be exercised against any person in the possession of the goods.<sup>79</sup> In addition, they are, in principle, not bound by time limits.<sup>80</sup>

The CISG appears to subscribe to the notion of prospective avoidance and, as such, certain contractual terms survive avoidance. Nevertheless, the process of mutual restitution bears some resemblance to the retrospective approach. Under Article 4(a), the Convention is not concerned with the effect of the contract on property in the goods sold; therefore, the recovery of the goods rests on avoidance and not on the concept that the property of the goods reverts back to the seller. The restitution under CISG is best described as a

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<sup>77</sup> Andrew Kull, 'Restitution As A Remedy For Breach Of Contract' (1993-1994) 67 S Cal L Rev 1465.

<sup>78</sup> UCC 2-702 (n 18) (recovery within 10 days when the buyer 'has received goods on credit while insolvent'); UCC 9-203(1)(a) (n 18) (security interest against debtor in possession must be based on a 'security agreement' signed by debtor); see also Honnold (n 4) para 444, 506; Tallon (n 1) 604.

<sup>79</sup> Certain acceptations may apply to protect the good faith third party.

<sup>80</sup> Fountoulakis (n 4) para 5, 1101, para 7, 1102-1103.

performance of resale contract that cancels out the initial sale contract.<sup>81</sup> In essence, avoidance is a reversal of the sale contract which transforms the contract from a future-oriented ongoing relationship into a backward-oriented restitution relationship. While avoidance releases both parties from their obligations under it, it may also bring in contractual rules whose violation results in damages, such as a violation of the primary duties of the living contract. The seller needs to repay the price and the buyer also has an actionable right to force the seller to take redelivery of the goods.<sup>82</sup> Since the Convention entitles each party to reclaim his own performance,<sup>83</sup> any recourse to national law for such claims is unnecessary; national law on unjust enrichment or similar institutions does not apply.<sup>84</sup> The contractual framework continues to exist as a virtual roof until unwinding of the contract has been completed.<sup>85</sup> However, the seller may not be entitled to obtain re-possession of the goods as a specific performance of the resale contract unless the parties had agreed on the retention of title clause and such a clause is valid in accordance with the appropriate domestic law.

### **8.3.2 The rules of restitution**

#### **8.3.2.1 The expenses of restitution**

The breaching party bears the expenses of restitution because the cost of restitution is an element in estimated due damages to the innocent party.<sup>86</sup> However, the innocent party should not exaggerate in order to increase this cost and he has to take reasonable and

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<sup>81</sup> *Dividing Wall Panels Case* (n 3); Michael G Bridge, 'The Nature and Consequences of Avoidance Convention on the International Sale of Goods' (2008-2009) 10 *International Law Review of Wuhan University* 118, 119.

<sup>82</sup> Magnus (n 24) 432; Bridge (n 81) 119.

<sup>83</sup> Article 81 CISG (n 2); see also Article 7.3.6(1) UNIDROIT (n 2): 'On termination of contract either party may claim restitution of whatever it has supplied ...'; in PECL (n 2) several articles dealt with recovery upon termination 9:306, 9:307, 9:308, 9:309.

<sup>84</sup> Article 7(1) CISG (n 2). See also Magnus (n 24) 432; Fountoulakis (n 4) para 10, 1103.

<sup>85</sup> Fountoulakis (n 4) para 18, 1107.

<sup>86</sup> Tallon (n 1) 605.

appropriate measures in the circumstances to mitigate his loss resulting from the breach by the other party.<sup>87</sup>

It follows that if the buyer declared avoidance because of the lack of conformity of the goods, he does not bear the cost of re-shipping the faulty goods to the seller while the breaching buyer will bear the cost of restitution if the avoidance of the contract was based on his fundamental breach. The cost of restitution burdens the party in breach. However, if the avoidance of the contract was because of an impediment, the expenses for restitution in this case would be borne by both parties, ie each party would be liable for his own expenses in carrying out the restitution of the goods or money.<sup>88</sup>

If the shipment of the goods was too expensive, the breaching party may resort to the solution provided in Article 85 which allows for the sale of the goods locally and the restitution of the resale price. This also corresponds to the good faith practice and a duty to mitigate the loss.<sup>89</sup>

### **8.3.2.2 Asserting the right to restitution**

A party that has performed the contract is not obliged to claim restitution for his previous performance. Therefore, it is a condition for the claim restitution of what has been supplied or paid that the right to such restitution is asserted. This is justified because one party may wish to leave what has been supplied or paid with the other party,<sup>90</sup> without prejudice to the interests of the avoiding party. If, for example, the goods were of no value at all because they were defective from the beginning, restitution would worsen the seller's situation rather than protect him. In such a case, the seller may require the buyer to resell the goods and deduct the

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<sup>87</sup> Article 77 CISG (n 2).

<sup>88</sup> Tallon (n 1) 606.

<sup>89</sup> According to the duty of 8.3.2.5 Preservation of goods.

<sup>90</sup> Fritz Enderlein and Dietrich Maskow, *International Sales Law: United Nations Convention on Contracts for the International Sale of Goods Convention on the Limitation Period in the International Sale of Goods* (Oceana 1992) para 6.2, 343.

sales price from the amount of damages due to the buyer if avoidance was because of a breach by the seller. The seller may request the buyer to resell the goods, even after claiming restitution, if he has found that the goods have been damaged in whole or in part. If the goods were totally worthless and dumping of such goods was too expensive, the breaching seller may ask the buyer to dump the goods locally at his expense and add the incurred cost to the damages due to be paid. Although the CISG does not provide for it, this solution results from the good faith principle that requires the buyer to act according to the breaching seller's instructions with respect to the disposal of the goods as long as such an instruction does not cause the buyer unreasonable inconvenience. In addition, there would be no other way to enforce restitution, in the prescribed case, in a way other than performing such dumping at the seller's expense. If avoidance was because of the buyer's breach, the resale of the goods may be one of the buyer's obligations to the seller.

Restitution may be the only practical remedy for the seller if the buyer has gone bankrupt.<sup>91</sup> However, the response in the case of the bankruptcy of the buyer will be dependent on the applicable national law.<sup>92</sup> When a buyer falls into insolvency, the seller's recovery of the goods will be more effective than attempting to collect payment. However, the seller in seeking restitution may not succeed in his efforts because the Convention's rules on performance of the original duties do not bind the court to enter a judgment for specific performance unless the court would do so under its own law.<sup>93</sup> Furthermore, if the seller sought restitution, a third party creditor who had obtained and perfected a security interest in the goods may restrict the sellers' right to seek restitution. To avoid situations such as this, a seller would be wise to perfect a security interest in a manner consistent with the laws of the

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<sup>91</sup> Abd El Hamid (n 13) para 401.

<sup>92</sup> Tallon (n 1) 606.

<sup>93</sup> Article 28 CISG (n 2). See also similarly Honnold (n 4) para 440.2, 504; Enderlein and Maskow (n 90) 122; Tallon (n 1) 605; Fountoulakis (n 4) para 18, 1107.

country where the goods will be located in order to ensure that he will have a priority in the goods.<sup>94</sup>

### **8.3.2.3 The performance of restitution**

The Convention does not specify the way that restitution should be made; therefore, the parties' actions for restitution are governed by the applicable law.<sup>95</sup> The parties, however, may have provided provisions in their contract concerning the modes of restitution or they may even have come to a separate agreement on the modes of restitution after avoidance. Either way, their agreement should precede any other rules according to the party autonomy principle.<sup>96</sup> If no provisions were provided, the provisions governing the respective performance, such as those for delivery or payment, can be applied analogously. There is a general principle that the place for performing restitutionary obligations should mirror the place for performing the primary obligations.<sup>97</sup> Using the gap filling rule provided in Articles 7(2) and 31, a buyer complies with his duty to return the goods by placing them at the seller's disposal at the buyer's place of business.<sup>98</sup> However, some courts have found that such a matter falls outside the scope of the CISG and should be addressed under local rules governing enforcement of a judgment.<sup>99</sup> The latter view is contrary to the methodology of the Convention's interpretation and has never been supported within CISG jurisprudence.<sup>100</sup> In

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<sup>94</sup> *Usinor Industeel v Leeco Steel Products* Federal District Court Illinois, United States (28 March 2002).

<sup>95</sup> Tallon (n 1) para 6.2, 606.

<sup>96</sup> *ibid* 605.

<sup>97</sup> *In-line Skates Case* Appellate Court Hamm, Germany (5 November 1997).

<sup>98</sup> *Dividing Wall Panels Case* (n 3).

<sup>99</sup> *Société Productions v Roberto Faggioni* Appellate Court Paris, France (14 January 1998); *Sport Clothing Case* District Court Landshut, Germany (5 April 1995).

<sup>100</sup> Alejandro Osuna Gonzalez, 'Dealing with Avoidance and Its Consequences: Articles 49(2), 64(2), and 81 through 88' in Harry M Flechtner and others (eds), *Drafting Contracts Under the CISG* (Oxford University Press 2008) 481.

addition, the aggrieved party may require as damages the costs that he had incurred in returning what he has been supplied or he has paid.<sup>101</sup>

#### **8.3.2.4 Mutual restitution rule**

The Convention sets a rule of concurrent restitution; if the parties are bound to make restitution, they must do so concurrently.<sup>102</sup> This rule is not meant to be implemented literally since in international trade ‘concurrency does not mean a direct change from one hand into the other’.<sup>103</sup> The parties have to agree the sums and/or obtain a decision on them before the concurrent restitution takes place. This means that in any event the arrangements will have to be made between the parties. When they do not succeed, the forms of concurrent performance provided in Article 58 may be taken to be a guide for concurrent restitution. Where the avoidance is caused by the seller who delivered fundamentally non-conforming goods, the buyer may demand that a letter of credit be opened as a condition for the restitution. However, when the contract is avoided because the buyer has stopped paying instalments, the seller will at best be willing to repay the refundable part of the price on the condition of cash against documents, and require the granting of an opportunity to examine the goods to be restituted.<sup>104</sup>

However, concurrent forms of restitution should not be applied to the advantage of a party whose breach of contract gave rise to the avoidance. The concept of the concurrent restitution rule is that each party will have the right to withhold restitution if it was clear that the other party would not perform the essential part of his restitutionary obligations. Not only is the aggrieved party entitled to avoid the contract but he may also rely on the principle of

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<sup>101</sup> Enderlein and Maskow (n 90) 344.

<sup>102</sup> Article 82(2) CISG (n 2); similarly Article 637(1) UNIDROIT Principles (n 2).

<sup>103</sup> Enderlein and Maskow (n 90) 344.

<sup>104</sup> Article 58(1) CISG (n 2); See also Enderlein and Maskow (n 90) 344.

concurrent restitution and he is therefore not obliged to perform the restitution in advance.<sup>105</sup> Furthermore, the avoiding party may withhold restitution until he is paid the damages due.<sup>106</sup> In this case, it was held that an avoiding seller need not make restitution of the buyer's payments until the delivered goods were returned.<sup>107</sup> The avoidance, therefore, may not constitute chronological reverse of performance.

### 8.3.2.5 Preservation of goods

The duty of preservation of goods survives the termination of the contract.<sup>108</sup> Where a party retains the goods as a security for the others' counter-performance or in order to be reimbursed his reasonable expenses, he must take such steps as are reasonable in the circumstances to preserve them. This duty to preserve the goods may oblige the buyer or the seller to be in possession of the goods or in control of their disposition,<sup>109</sup> especially in those cases where the risk of loss has already passed to the other party.<sup>110</sup> The seller who is in possession of the goods or who is able to control their disposition must take such steps as are reasonable in the circumstances to preserve them if the buyer is in delay in taking delivery, where payment of the price and delivery of the goods are to be made concurrently, or if he

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<sup>105</sup> For the counter view that concurrent is for both parties see Fountoulakis (n 4) 1108.

<sup>106</sup> Abd El Hamid (n 13) para 404.

<sup>107</sup> Article 85 provides that: 'If the buyer is in delay in taking delivery of the goods or, where payment of the price and delivery of the goods are to be made concurrently, if he fails to pay the price, and the seller is either in possession of the goods or otherwise able to control their disposition, the seller must take such steps as are reasonable in the circumstances to preserve them. He is entitled to retain them until he has been reimbursed his reasonable expenses by the buyer.' Article 86(1) provides that, 'If the buyer has received the goods and intends to exercise any right under the contract or this Convention to reject them, he must take such steps to preserve them as are reasonable in the circumstances. He is entitled to retain them until he has been reimbursed his reasonable expenses by the seller'; *Roder v Rosedown* (n 72).

<sup>108</sup> Vilus (n 5) 261; Magnus (n 24) 423;

<sup>109</sup> Jorge Barrera Graf, 'Article 85' in Bianca and Bonell (n 1) 618; Jorge Barrera Graf, 'Article 86' in Bianca and Bonell (n 1) 621; Peter Huber, 'Preservation of goods' in Peter Huber, Alastair Mullis, *The CISG: A new textbook for students and practitioners* (Sellier 2007) 362.

<sup>110</sup> Article 69(1) CISG (n 2). See also Peter Schlechtriem, *Uniform Sales Law: The UN-Convention on Contracts for the International Sale of Goods* (Manz 1986) 109.

fails to pay the price.<sup>111</sup> This duty finds its origins in the general principles of the Convention: to perform the contract in good faith<sup>112</sup> and to mitigate the loss resulting from the breach.<sup>113</sup> Furthermore, the Convention expressly provides for it in Article 85,<sup>114</sup> combined with a right to retain the goods until he has been reimbursed his reasonable expenses of preservation.<sup>115</sup> According to Article 86 CISG,<sup>116</sup> the buyer has the same obligations to preserve the goods and the rights as the seller has under Article 85 CISG.<sup>117</sup>

If, in reality, the buyer has no right to reject the goods, it is in his own interest to preserve them because he bears the risk of their loss or deterioration.<sup>118</sup> This obligation to preserve the goods may take several forms: the buyer may take reasonable care to preserve the goods, take possession of the goods on behalf of the seller, or take other reasonable steps to preserve them.

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<sup>111</sup> Article 85 CISG (n 2).

<sup>112</sup> Article 7 CISG (n 2); Graham Corney, 'Obligations and remedies under the 1980 Vienna Sales Convention' (February 1993) 23(1) Queensland Law Society Journal 37.

<sup>113</sup> Articles 85 and 88 together with Article 77 set forth a general principle of the Convention to mitigate the loss resulting of the breach. See Honnold (n 4) 522; see also Graf (n 109) 617.

<sup>114</sup> The immediate predecessor of Article 85 CISG (n 2) was Article 91 of ULIS (n 10). This read: 'Where the buyer is in delay in taking delivery of the goods or in paying the price, the seller shall take reasonable steps to preserve the goods; he shall have the right to retain them until he has been reimbursed his reasonable expenses by the buyer.'

<sup>115</sup> Huber (n 109) 362.

<sup>116</sup> Article 86(1) provides that, 'If the buyer has received the goods and intends to exercise any right under the contract or this Convention to reject them, he must take such steps to preserve them as are reasonable in the circumstances. He is entitled to retain them until he has been reimbursed his reasonable expenses by the seller.' The antecedent of Article 86 may be found in Article 92 of ULIS (n 10) was nearly the same terms as the present version other than a slight modification. See Klaus Bacher, 'Article 86' in *Schlechtriem and Schwenzler* (n 1) 1154, para 2.

<sup>117</sup> Vilus (n 5) 261; See Bacher (n 116) para 1, 1154; Osuna Gonzalez (n 100). However, Honnold came to a conclusion that a buyer's duty to preserve the good under Article 86 CISG is not similar to the duty of the seller posed in Article 85 CISG because paragraph (1) of Article 86 CISG is not applicable since the buyer has not 'received' the goods, and paragraph (2) is not applicable since the buyer can only get possession by paying the price. See Honnold (n 4) para 455, 524.

<sup>118</sup> Bacher (n 116) para 6, 1155.



### 8.3.2.5.1 The buyer's duty to take reasonable care to preserve the goods

The avoiding buyer will generally protect the goods from substantial damage because he otherwise loses the right to avoid the contract or to demand substitute goods if he causes the goods to be lost or damaged.<sup>119</sup> Depending on the facts of each case, the buyer may also be required to preserve the goods from insubstantial deterioration or otherwise be liable for damages.

When the goods have been received by the buyer and he intends to reject them, he has to take reasonable steps to preserve those goods from insubstantial deterioration<sup>120</sup> even if the risk would have passed to him at that time.<sup>121</sup> The significance of this duty is that the buyer who intends to reject the goods on the ground of fundamental breach<sup>122</sup> or because of excessive delivery or delivery before the due date<sup>123</sup> would have little incentive to preserve them because the risk of loss would pass back to the seller.<sup>124</sup> Therefore, Article 86(1) CISG is designed to give such an incentive to the avoiding buyer who has the goods in his possession or control.<sup>125</sup> This situation presupposes that the buyer is in physical possession of the goods but he intends to exercise his right under the contract or the Convention to return them.<sup>126</sup> The existence of an obligation to preserve the goods cannot depend on whether or not the buyer has definitely decided to reject them. It is generally agreed that it is not necessary for the buyer to have formed a definite intention to reject the goods. Rather, it is the case that the

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<sup>119</sup> Article 82(1) CISG (n 2); see also Schlechtriem (n 110) 109.

<sup>120</sup> If the deterioration was substantial the buyer will lose his right to avoid the contract or require substitute delivery.

<sup>121</sup> Articles 67-69.

<sup>122</sup> Either to avoid the contract (Article 49(1)(a)) or request delivery of substitute goods (Article 46(2)).

<sup>123</sup> Article 52 CISG (n 2); see also Honnold (n 4) 525.

<sup>124</sup> Article 70 CISG (n 2).

<sup>125</sup> The obligation to preserve the goods is an expression of the general obligation to cooperate as one of the Convention's underlying principles; see Francesco G. Mazzotta 'Preservation of the Goods: Comparison of Articles 85-88 CISG and counterpart provisions of the Principles of European Contract Law' para 1 <<http://www.cisg.law.pace.edu/cisg/biblio/mazzotta1.html>> accessed 22 June 2015.

<sup>126</sup> Schlechtriem (n 110) 109; Graf (n 109) 621.

goods still need to be protected even while the buyer is considering rejection as one of several alternative courses of action. The duty to preserve the goods matures after the seller's breach even if the buyer has only later become aware of the significant danger of breach or of his right to reject them.<sup>127</sup>

#### **8.3.2.5.2 Take possession of the goods on behalf of the seller**

The avoiding buyer is required to take possession of the goods on behalf of the seller if the goods have been placed at his disposal at their agreed destination<sup>128</sup> even though he does not have physical possession of the goods and has been discharged of his obligation to take delivery. The duty of the buyer to take possession of the goods for the account of the seller is conditioned on the fact that taking possession of the goods can be done without payment of the price (if the price has not been paid already) and without unreasonable inconvenience or unreasonable expense, and neither the seller nor his agent are present to take charge of them.<sup>129</sup> This is the case where the transportation of the goods involves independent carriers and where goods may be shipped across long distances and the seller has no representative at his destination to protect his interests if the goods are rejected by the buyer.<sup>130</sup> In such circumstances, it is assumed that the buyer will ordinarily be better placed than the seller to take care of the goods. However, the buyer is released from this duty if the seller or a person authorized to take charge of the goods on his behalf is present at the destination.<sup>131</sup> Once the goods come into the possession of the buyer, he will be obliged to preserve them in accordance with Article 86(1) CISG.

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<sup>127</sup> See Honnold (n 4) 525; Bacher (n 116) para 7, 1155; But see contrary view in Honnold 'The provision requires that the buyer manifest his intention at the moment of receipt of the goods', see also Graf (n 109) 622.

<sup>128</sup> Article 86(2) CISG (n 2).

<sup>129</sup> Schlechtriem (n 110) 109; Graf (n 109) 622.

<sup>130</sup> Enderlein and Maskow (n 90) note 6, 356; Ziegel and Samson (n 17) comment on Article 86.

<sup>131</sup> Vilus (n 5) 261.

### 8.3.2.5.3 The reasonable steps to preserve the goods

The buyer must adopt measures that are reasonable in the circumstances in order to preserve the goods. In most cases, the buyer will preserve the goods for his own interest, in order not to lose his right to avoid the contract.<sup>132</sup> The steps that can be considered reasonable in the circumstances will have to be determined using the measure which the CISG applies in Article 8, paragraph 2, in order to flesh out such vague descriptions. It amounts to taking such steps that a reasonable person in the same circumstances would take.<sup>133</sup> He may do so in accordance with the type of goods and the nature of their use. The buyer may be required to repair the packaging of the goods, protecting them from rain or direct sunlight, putting them in refrigerators so they are not spoiled, or even having them insured against certain risks.<sup>134</sup>

The Convention provides for two examples for certain reasonable preservation measures in Articles 87 and 88 CISG. The buyer may deposit the goods in a warehouse of a third person at the expense of the seller provided that the expense incurred is not unreasonable. The buyer must choose a suitable warehouse; if he chooses one that is obviously inadequate (for example, lack of refrigeration, excessive humidity or sunlight), or that is ‘unreasonably’ expensive then he may be liable for damages.<sup>135</sup>

The Convention requires the buyer to make reasonable efforts to preserve the goods by whatever means appropriate. The buyer may have the optional right to sell the goods or he may have a duty to sell them.<sup>136</sup> According to Article 88(1), a buyer may be entitled to sell the goods if there has been an unreasonable delay by the seller in taking them back or in paying the cost of preservation. To make the sale, notice to the other party is required. If the

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<sup>132</sup> Article 82, para 1; Schlechtriem (n 110) 104.

<sup>133</sup> Enderlein and Maskow (n 90) 353.

<sup>134</sup> Abd El Hamid (n 13) para 419.

<sup>135</sup> Huber (n 109) 364.

<sup>136</sup> Honnold (n 4) 527.

goods are subject to rapid deterioration or their preservation would involve unreasonable expense, the buyer is bound to sell the goods as a means of preserving them. The buyer who wishes to sell must give the seller reasonable notice of his intention, as far as possible, so that the seller may take steps to avoid the sale or to be present directly or through a person that he appoints.<sup>137</sup> The sale may be conducted by any appropriate means; it is enough to do this pursuant to a method recognized by the domestic law applicable in the place of sale and which the selling party considers the most convenient and adequate in relation not only to the nature of the goods but also to the interests and rights of the contracting parties.<sup>138</sup>

The buyer's duty to preserve the goods may endure as long as the goods remain in his possession. If the warehouse keeper damages the goods during the time of deposit or the goods are destroyed by the carrier, the buyer should not be liable for such loss.<sup>139</sup> Such a solution is termed the mirror principle, whereby restitutionary obligations should mirror the primary contractual obligations. Once the buyer has handed over the goods to a carrier for their return to the seller or has reasonably deposited them with a third party, the risk reverts back to the seller and the buyer is discharged from his obligation to preserve the goods.<sup>140</sup>

### **8.3.3 The subject matter of the restitution (interests and benefits)**

Each party is accountable for advantages gained from his breach or even from faulty performance of the other party. The mode of assessment of these advantages comes in one of two shapes: interest on money derived from the payment made or from failure to comply with a monetary obligation, and benefits derived from the goods.

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<sup>137</sup> Jorge Barrera Graf, 'Article 88' in Bianca and Bonell (n 1) 629.

<sup>138</sup> *ibid* 628.

<sup>139</sup> Huber (n 109) 364.

<sup>140</sup> *Dividing Wall Panels Case* (n 3); See also Osuna Gonzalez (n 100) 481.

### 8.3.3.1 Restitution of interest

The Convention entitles the creditor to interest in two situations: whenever the debtor has failed to pay the price or any sum in arrears as per Article 78; and whenever the seller is obligated to make restitution of the price as per Article 84(1). Article 78 gives the creditor, whether a buyer or a seller, a right to interest on the price and any sum in arrears that the debtor failed to pay. Article 84(1) provides that if the seller is bound to refund the price, he must also pay interest on it from the date on which the price was paid.<sup>141</sup> However, the Convention does not answer the question of how the interest should be measured or at what rate the interest is payable. Delegates at the Vienna Conference found it difficult to find a specific formula which was both clear and acceptable to the participants.<sup>142</sup> Disputes over the rates of interest were taken up by legal writers and various solutions have been developed. The best known solutions on how to establish the rate of interest under Articles 84(1) and 78 CISG<sup>143</sup> can be classified into two groups. The first group considers that calculating the rate of interest is a matter governed by, but not expressly settled in, the Convention; therefore, adopts a uniform approach to determine the rate of interest on the basis of the general

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<sup>141</sup> Article 84 CISG (n 2).

<sup>142</sup> A proposal was made that, in view of the difficulty, the Convention should not only omit a provision on interest but also include a statement that it was not concerned with questions of interest (and that the provision now in Article 84(1) should be deleted).

<sup>143</sup> For more details on these solutions see: Chengwei Liu, 'Recovery of Interest' (November 2003) *Nordic Journal of Commercial Law*; André Corterier, 'A New Approach to Solving the Problem of the Interest Rate Under Article 78 CISG' (2000) 5 *International Trade and Business Law Annual* 33; Franco Ferrari, 'Uniform Application and Interest Rates Under the 1980 Vienna Sales Convention' (1995) *Cornell Review of the Convention on Contracts for the International Sale of Goods* 3; John Y Gotanda, 'When Recessions Create Windfalls: The Problems of Using Domestic Law to Fix Interest Rates under Article 78 CISG' (2009) (1)13 *Vindobona Journal of International Commercial Law and Arbitration* 229; Phanesh Koneru, 'The International Interpretation of the UN Convention on Contracts for the International Sale of Goods: An Approach Based on General Principles' (1997) 6 *Minnesota Journal of Global Trade* 105.

principles underlying the Convention. The second group considers this is a domestic matter that is not governed by the Convention.<sup>144</sup>

### **8.3.3.1.1 Uniform approach**

This approach tries to find the purpose of entitlement to the right of interest within the general principles on which the Convention is based. Three opinions can be identified under this approach. The first view bases the interest rate on the creditor's place of business.<sup>145</sup> It considers interest in Article 78 CISG as compensation for the loss suffered by the creditor as a consequence of the failure to make payment, thus providing a solution by analogy to the Convention's rules on compensation for breach of contract in Articles 74, 75 and 76 CISG.<sup>146</sup> Article 78 CISG entitles the creditor to a right to interest on the price and any sum in arrears that the debtor failed to pay. Thus, the seller has a right to the interest he could have received had the buyer paid the price on time.<sup>147</sup> The provision in Article 84(1) CISG applies the general rule established in Article 78 of the Convention.<sup>148</sup> The buyer has a right to the interest he could have received had he not paid the seller. Therefore, the interest due must be based on the rate applicable at the buyer's place of business.<sup>149</sup>

The second view is that the question of the applicable interest under Article 84(1) CISG should be treated separately from that under Article 78 CISG. It is necessary to distinguish

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<sup>144</sup> According to Article 7(2) of the CISG (n 2), a matter governed by but not expressly settled in the Convention should be settled in conformity with the general principles on which the Convention is based; only in the absence of such principles is the law applicable by virtue of the rules of private international law to be consulted.

<sup>145</sup> As we have seen in Article 78 neither UNCITRAL nor the Diplomatic Conference found it feasible to specify the rate of interest; the above discussion of Article 78 suggests that the solution should be derived by analogy to the Convention's rules on compensation for breach of contract (Articles 74, 75 and 76). However, the Conference was unable to agree on this particular point. See Tallon (n 1) 612.

<sup>146</sup> Honnold (n 4) 515.

<sup>147</sup> If the contract is avoided according to Article 49 CISG is based on the seller breach, the seller is not entitled to interest for the not paid price.

<sup>148</sup> Klaus Bacher, 'Article 78' in Schlechtriem and Schwenzer (n 1) 1049.

<sup>149</sup> Bacher (n148) para 1, 1094.

the discussion on the applicable interest rate in Article 78 from the one in Article 84(1) CISG. Article 78 concerns the duty to pay interest on payments which were not made in time while the obligation to pay interest under Article 84(1) CISG deals with the seller's obligation to make restitution and not the buyer's obligation to claim damages. Article 84(1) is based on the concept of unjustified enrichment where the seller must account for the benefits he has derived from receipt and use of the purchase price.<sup>150</sup> Unjustified enrichment offers the possibility of using the money at the seller's place of business. Therefore, the calculation of interest should be linked to this place.<sup>151</sup>

A third opinion allows for various options to calculate the rate of interest depending on whether the creditor was in breach or not. The rate of interest is to be based on the loss suffered by the creditor, ie the person who should have received the payment. However, if the interest is claimed by the party in breach, in order to prevent unjust enrichment the restitutionary approach seems more appropriate. Therefore, if the contract was avoided because of the buyer's fundamental breach, interest should be based on the benefit the seller received from the use of the money.<sup>152</sup> However, if the contract was avoided because of the seller's breach, the interest of the recovered money should be based on the loss suffered by the buyer by connecting the place of performance to the payment of interest.<sup>153</sup>

### **8.3.3.1.2 Domestic law approach**

Several courts have treated this issue (the rate of interest) as one that is not governed by the Convention. According to this view, the rate of interest is an issue outside the Convention's scope. Therefore, it must be settled in conformity with the proper law applicable to the contract under the rules of private international law without recourse to the general principles

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<sup>150</sup> Christiana Fountoulakis, 'Article 84' in *Schlechtriem and Schwenger* (n 1) para 17, 1136.

<sup>151</sup> *ibid* para 18, 1137.

<sup>152</sup> Honnold (n 4) 515.

<sup>153</sup> By analogy to Articles 74, 75 and 76; Honnold (n 4) 515.

of the Convention. That is, the law that would be applicable to the sales contract if the Vienna Convention were not applied.<sup>154</sup> Furthermore, the question of the rate of interest is considered to be part of the contract itself, thus, it must be settled according to the same law as that of the contract itself. This view has been described as a prevailing opinion according to one decision<sup>155</sup> and a unanimous opinion according to another.<sup>156</sup> In determining the applicable law, the court first had to establish whether there was a valid choice of law clause in the contract.<sup>157</sup> If there is neither an express nor an implied choice, the applicable law is ascertained according to the law of the country with which the contract is most closely connected. Such connections are primarily found in the country of residence or place of business of the party carrying the characteristic obligation; this being, in the case of a sale, the seller.<sup>158</sup>

Some courts and arbitral tribunals have sought a solution under Article 9 of the Convention and have determined the rate of interest by reference to relevant trade usages<sup>159</sup> or simply by referring to a commercially reasonable rate.<sup>160</sup> However, there might be difficulties in defining what constitutes a commercially reasonable rate. One ICC arbitration award

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<sup>154</sup> *Optical Equipment Case* District Court Locarno, Switzerland (16 December 1991); *Copy Paper Case* Appellate Court Lugano, Switzerland (12 February 1996); E Allan Farnsworth, 'CISG' in Bianca and Bonell (n 1) 570; Joseph Lookofsky 'Article 84' in Herbots and Blanpain (n 43) 1.

<sup>155</sup> The court observed: '... The rate of interest is not regulated by Article 84 CISG. In addition, in Article 78 CISG no mention is made of the rate of interest. According to the prevailing opinion, the rate of interest within the scope of Article 78 CISG is governed by the applicable national law, which is determined by the rules of private international law. This notion is also applicable to Article 84 CISG.' *Sport Clothing Case* (n 99).

<sup>156</sup> 'According to unanimous opinion and the case law of this Court ... the interest rate is to be settled in conformity with the law applicable by virtue of the rules of private international law. In-line Skates Case (n 97).

<sup>157</sup> *Knitware Case* Lower Court Kehl, Germany (6 October 1995).

<sup>158</sup> Article 28 Einführungsgesetz zum Bürgerlichen Gesetzbuche (EGBGB) (Civil Code Introduction Act), Article 4 Convention on the Law Applicable to Contractual Obligations (19 June 1980) (Rome Convention); Volker Behr, 'The Sales Convention in Europe: From Problems in Drafting to Problems in Practice' (1998) 17 *Journal of Law and Commerce* 263.

<sup>159</sup> *Steel Bars Case* ICC Arb Case No 6653 (26 March 1993).

<sup>160</sup> The interest rate of the currency in which damages had to be paid. *Electrical Appliances Case* ICC Arb Case No 8769 (December 1996).



considered the London Inter-Bank Offered Rate (LIBOR) as a reasonable rate of interest<sup>161</sup> but this arbitral award was later annulled on the grounds that international trade usages do not provide appropriate rules to determine the applicable interest rate.<sup>162</sup>

There is another opinion that classifies it under the domestic law approach: this opinion bases its solution on the contractual agreement, specifically, the currency in which the payment was to be made.<sup>163</sup> The argument of this approach is that the usual rate of interest is normally related to a particular currency, in particular, the relevant inflation rate for that currency. According to this view, if the sum is payable in US dollars it is sensible both from the point of view of damages and of compensation for benefits received that the creditor should be allowed to claim the prime rate of the currency involved, in this instance, the prime rate fixed by the US Federal Reserve.<sup>164</sup>

### **8.3.3.1.3 Evaluation**

The text of Article 78 CISG speaks of interest as something distinct from damages by stating that entitlement to interest should not prejudice any claim for damages recoverable under Article 74. This vague wording can hardly be used to advance any arguments based on the reasoning behind Article 78. It is not clear whether the aim of Article 78 is to prevent unjust enrichment by the debtor from keeping the money or to compensate the creditor for the loss suffered assuming that he had to take a loan at his place of business. What is clear from Articles 78 and 84(1) CISG is that the right to interest depends solely on whether a payment is due and unpaid on the appointed date for payment.<sup>165</sup> Unjustified enrichment and harm caused by keeping the money are external factors that remove the discussion of entitlement to

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<sup>161</sup> *Steel Bars Case* (n 159).

<sup>162</sup> *Thyssen v Matden* Appellate Court Paris, France (6 April 1995).

<sup>163</sup> *L v SA C* District Court Ieper, Belgium (18 February 2002); Enderlein and Maskow (n 90) 209; Bacher (n 148) 1057.

<sup>164</sup> Bacher (n148) 1057.

<sup>165</sup> *Garment Case* Commercial Court Aargau, Switzerland (19 December 1997); Bacher (n 148) 1057.

interest from its proper context. Furthermore, abstract solutions based on the creditor's place of business or the debtor's place of business may lead to unfair and unjust results because the parties to the contract are subjected to different rates of interest rather than a uniform one. To achieve justice or the equalization of the parties to a sale contract, the debtor and the creditor should be subject to the same rate of interest. Otherwise, one party would be granted an advantageous status over the other by entitling him to claim a higher interest rate for the debts than the other party would have had in a similar situation. This result was definitely not the intention of the participants at the Vienna Conference; neither would it be acceptable according to the general principle of good faith on which the interpretation of the CISG must be based.

It seems impossible to settle the rate of interest dispute without resorting to domestic law. The solutions which claim to provide uniformity by referring to current provisions of the Convention or its general principles all ultimately apply the domestic laws of the creditor's or debtor's place of business and these do not necessarily match the principles of the Convention. Even after admitting that the application of domestic law in determining the interest rate should be regarded as inappropriate, there is no other substitute to apply because the interest rate has not been expressly regulated within the Convention nor does its uniform principle state how to calculate the amount of interest. An express provision needs to be included to bring clarity to this dispute.

Connecting the rate of interest to the law of the currency in which the sum is to be paid has more merit but raises other problems, especially if the contract currency is from one of those countries where there is a statutory prohibition on interest or if the amount to be paid is in a multi-national currency such as the euro.<sup>166</sup> It is therefore necessary to determine whether the

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<sup>166</sup> Bacher (n 148) 1057.

parties, by entering into a contract, have accepted to pay interest in case of late payment. Interpreting Article 78 based on the assumption that the parties are obliged themselves to pay interest is a kind of homeward trend interpretation for international sale contracts and must be rejected. Only if an express or implied agreement discerns how the rate of interest for unpaid sums is to be calculated can an appropriate solution be found for the purposes of Article 78. Any doubt should be interpreted in favour of the debtor. Such a proposal would not prejudice the creditor if he has suffered some loss for not being paid on time as long as Article 74 provides him with a comprehensive level of compensation.

### **8.3.3.2 Restitution of benefits: Article 84(2)**

The buyer, subject to the seller's claim for restitution of delivered goods, must account to the seller for all the benefits which he has derived from the goods or part of them in two situations: whenever the buyer is obligated to make restitution of the goods according to Article 84(2)(a); and whenever the buyer successfully avoids the contract or requires the seller to deliver substitute goods despite being unable to make restitution of the original goods substantially in the condition in which they were received, ie when one of the Article 82(2) exceptions from the requirement to make restitution applies.<sup>167</sup> The solution has been attributed to the general principle of unjust enrichment.<sup>168</sup> Therefore, the buyer must account only for the net benefits of the received goods.<sup>169</sup> The notion of unjustly enriched benefits in Article 84(2) has been criticized as the buyer may indeed have derived some advantage from the goods without deteriorating them but the extent of the possible benefits is also difficult to prove because the use of defective goods is not always a measurable monetary benefit and would thus have to be considered as an imposed benefit.<sup>170</sup> If this provision is to be

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<sup>167</sup> Denis Tallon, 'Article 84' in Bianca and Bonell (n 1) 612.

<sup>168</sup> *ibid* 612.

<sup>169</sup> Fountoulakis (n 150) para 27, 1139.

<sup>170</sup> *Furniture Case* Appellate Court Oldenburg, Germany (1 February 1995).

interpreted by saying that the buyer should have to provide restitution of any monetary profit he derived from the goods, assuming that the buyer had succeeded in reselling goods received under the avoided contract, then the buyer's attempt to resell the defective goods was merely an effort to mitigate the negative effect for both sides of the non-conforming goods according to Article 77<sup>171</sup> and should not be based on the general principle of unjust enrichment or by resorting to the applicable law on a quasi-contract.

The Convention does not answer the question of whether the buyer who is bound to make restitution is liable for any benefits he could have derived from the goods which he did not. The Convention contains no provisions that could serve as a basis for the duty to derive benefits from possession of the goods and that would support claims for the failure to do so. Therefore, claims based on failure to derive benefits should be denied.<sup>172</sup>

#### **8.4 Conclusion**

The Convention allows each party to the avoided contract the right to request restitution of his own performance. However, it does not specify how restitution is to be made in order to achieve a balance between the parties. Each party has to account to the other party for the benefits obtained from the counter-performance: the seller should pay the interest with the price and the buyer should compensate for any benefit obtained from the goods. The cost of restitution is the responsibility of the breaching party.

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<sup>171</sup> *Shoes Case* Lower Court Charlottenburg, Germany (4 May 1994).

<sup>172</sup> Schlechtriem (n 110) 108.

## **Conclusion**

This study has set out to address the concept of fundamental breach and avoidance under the CISG. The Convention provides the aggrieved party with an expedited means of discharging himself from the contract by mere declaration of avoidance in a way that permits the non-performing party to avoid any loss due to uncertainty as to whether the aggrieved party will accept the performance. At the same time, it prevents the aggrieved party from speculating on a rise or fall in the value of the performance to the detriment of the non-performing party. It is important to preserve the contract wherever possible but it is also important to protect the interests of the aggrieved party by recognizing his right to avoidance if the performance did not conform to his expectations of the contract.

The avoidance is exercised by the unilateral declaration of the aggrieved party without the need for judicial intervention. However, the ability to avoid a contract is subject to two formal requirements. The first formality is the mandate that a declaration of avoidance must be made through a notice to the defaulting party. The second formality is that the avoidance must be made within a reasonable time if the goods have been delivered or the price has been paid in full. If the breach has already been disputed before the court, the court or arbitral tribunal will not provide for any period of grace granted to the defaulting party. The Convention has implemented a uniform concept of breach and, in general, the system of remedies does not distinguish between various types of breached obligations.

There are two mechanisms to avoid the contract; the first is fundamental breach and the second is Nachfrist. Avoidance under the CISG basically depends on whether the debtor has committed a fundamental breach of contract. In limited situations, an aggrieved party can set a Nachfrist period after which he has the right to avoidance if the other party fails to render his performance. Avoidance via Nachfrist procedures is available only in a limited number of cases: late delivery, late payment or refusing to take delivery. Nachfrist procedures avoid the

contract by setting a time limit for a breaching party. Defaulting on this time period will mean that the contract can be avoided. While the procedures of Nachfrist provide predictable consequences for breach of contract and an uncontroversial right to avoidance, the concept of fundamental breach has made the CISG the target of a great deal of criticism. Article 25 CISG is unclear about when a breach of contract is fundamental. The CISG defines fundamental breach by reference to two other concepts: detriment and foreseeability. This study attempts to define fundamental breach by defining the relationship between essential detriment and foreseeability as commonly understood in legal literature and court decisions. It seems that foreseeability serves to interpret parties' will which a court may examine by itself without being invoked as a defence by the breaching party. Foreseeability is used to interpret the reasonable range of strict compliance that the aggrieved party is entitled to under the contract. The aggrieved party is not entitled to avoid the contract if it was unreasonable for the innocent party to rely on the seller's skills and judgment to foresee the importance of single obligation compared to the whole performance of the contract.

The legal stance which aims to avoid the contract for fundamental breach is often unsafe because such a universal concept cannot be understood through the abstract definition provided in Article 25 CISG. The most careful analysis of the drafting history and the wording of Article 25 CISG cannot furnish an exact criterion to distinguish fundamental breach from non-fundamental breach. This thesis suggests seeing fundamental breach as a breach of particular obligations. This fragmented approach in studying substantial detriment and foreseeability for each single obligation could help to give guidance for the concrete application of the concept of fundamental breach. There are common interests and expectations that can be considered to be fundamental for every contract of sale. Judicial practice plays an important role in determining what the parties would have considered to be a substantial interest for performance had they applied their minds to it. However, the courts

have discretion in each litigated case to understand fundamental breach in the light of the parties' will in that specific case. The intention of the parties takes priority according to Articles 6 and 8(1) CISG over the default Convention rules. Hence, the contracting parties can modify, derogate from or opt out of Article 25 CISG entirely or partially. If the intention of the parties was not clear, it can be detected by subsequent conduct and usages as understood by a reasonable person. The complete disclosure of the parties' expectations is desirable in order to ensure that a contractual relationship may be relatively non-litigious.

There are several types of breaches that strongly suggest the existence of a fundamental breach of contract unless a different intention becomes clear in the language of the contract. Firstly, there is the ultimate failure to perform the main obligations such as to deliver, to pay or to take delivery. The buyers and sellers conclude the sale contract to get a counter-performance from the other party. The ultimate non-performance of the main obligations constitutes a fundamental breach.

Secondly, a breach of a re-import prohibition, exclusivity agreement, or type of transportation term can point to a fundamental breach. As a general rule, these sorts of breaches are fundamental because it is likely that the parties have intended them to have such an effect. However, the non-performance of these obligations does not necessarily result in a fundamental breach as long as it is clear from the contract language that the parties had not intended such a result.

Thirdly, late delivery and late payment or the taking of a delivery can be regarded as fundamental but only if they are expressly or impliedly stated to be so in the contract. In case of doubt, it is recommended that the aggrieved party should avoid the contract via the *Nachfrist* procedure. The late delivery in commodities and goods in volatile market prices is fundamental because an implicit agreement can be inferred from the circumstances that even

a short delay should entitle the buyer to declare the contract avoided. However, the buyers cannot benefit themselves of such implicit agreement if they did not rely or it was unreasonable for them to rely on a seller's skill and knowledge of the importance of timely delivery in the commodities market and, in general, if the seller's skill and judgment capacity is not common in the seller's trade branch.

Fourthly, the failure to comply with the marketing regulations of the buyer's country is a fundamental breach if it was reasonable to the buyer to rely on the seller's skill and judgment to provide conforming goods. As a general rule, a seller's non-conforming delivery is not fundamental as long as the goods can reasonably be used in the usual course of the buyer's business. However, the buyer's reasonable reliance on the seller's skill and judgment to provide goods conforming to specific standards in addition to actual or presumed knowledge of the seller of these standards are sufficient to establish a seller's responsibility for fundamental breach for failure to comply with these standards such as the marketing regulations of the buyer's country, quantity, packaging and usability for a particular purpose.

Finally, there is a curative breach. The occurrence of fundamental breach is independent of the fact that the breach can be cured. If the breach is fundamental, the buyer's right to avoid the contract prevails over the seller's right to cure in all cases where the time of delivery has passed. It does not hinder the occurrence of fundamental breach even if curing the defect is possible within an adequate time and the seller is willing to cure.

The result of the avoidance is the discharge of the contractual obligations for the future. Neither of the parties is allowed to require performance from the other. The Convention confirms that avoidance does not affect the right of the injured party to get damages as a result of breach of contract. Avoidance does not nullify any of the terms of the contract relating to the settlement of disputes, clauses of arbitration or any of the other provisions



governing the parties' rights and obligations arising from the avoidance of the contract, provided that these clauses are valid according to the applicable law. Avoidance does not affect the right of the injured party to get full compensation for his loss as a result of breach of contract.

The Convention has developed the rule of alternative transactions to calculate the damages in case of avoidance of the contract. The damages are equal to the difference between the price of the original deal and the price of the alternative transaction. There are two conditions to apply the alternative transaction rule: the alternative transaction must be reached within a reasonable time and in a reasonable manner with the best terms available in the market. If the innocent party has not concluded the alternative transaction, the damages are equivalent to the difference between the price specified in the contract and the current price at the time of avoidance. This rule should not prejudice the right of the injured party to full compensation. If the alternative transaction does not cover all damages, the injured party may ask to complete the damages according to Article 74 CISG.

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